STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Commonwealth Edison Company **Tariffs and charges submitted pursuant to Section 16-108.5 of the Public Utilities Act**	: : : : :	**Docket No. 11-0721**

POSITION STATEMENT OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

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Staff of the Illinois Commerce Commission ("Staff"), by and through its counsel, pursuant to Section 200 of the Rules of Practice (83 Ill. Adm. Code 200) of the Illinois Commerce Commission ("Commission"), respectfully submits its Position Statement in the above-captioned matter.

I. INTRODUCTION / STATEMENT OF THE CASE

Section 16-108.5 of the Public Utilities Act ("PUA" or "Act") provides that an electric utility or combination utility serving more than one million customers may elect to become a "participating utility" and voluntarily undertake an infrastructure investment program as described in the Section. A participating utility is allowed to recover its expenditures made under the infrastructure investment program through the ratemaking process, including, but not limited to, the performance-based formula rate and process set forth in Section 16-108.5. (220 ILCS 5/16-108.5(b)).

On November 8, 2011 Commonwealth Edison Company ("ComEd") filed its performance-based formula rate tariff, Rate DSPP – Delivery Service Pricing and Performance ("Rate DSPP") under Section 16-108.5 which the Illinois Commerce Commission ("Commission") suspended on the same day. (Suspension Order, Docket No. 11-0721, November 8, 2011)

The following Staff witnesses submitted testimony in this case: Theresa Ebrey (Staff Exs. 1.0 and 13.0), Steven Knepler (Staff Exs. 2.0 and 14.0), Daniel Kahle (Staff Exs. 3.0 and 15.0), Mike Ostrander (Staff Ex. 4.0), Richard Bridal (Staff Exs. 5.0 and 16.0), Scott Tolsdorff (Staff Ex. 6.0 and 17.0), Rochelle Phipps (Staff Exs. 7.0 and 18.0), Yassir Rashid (Staff Ex. 8.0 and 19.0), Peter Lazare (Staff Exs. 9.0 and 20.0), Phillip Rukosuev (Staff Exs. 10.0 and 21.0), Greg Rockrohr (Staff Exs. 11.0 and 22.0), and Sheena Kight-Garlisch (Staff Exs. 12.0 and 23.0).

In addition to ComEd, the following parties have submitted testimony in this case: the Citizens Utility Board ("CUB"), the Illinois Industrial Energy Consumers ("IIEC"), the Peoples of the State of Illinois ("AG") and AARP ("AG/AARP"), the Chicago Transit

Authority (“CTA”) and the Northeast Illinois Regional Commuter Railroad Corporation d/b/a METRA (“METRA”) (“CTA/METRA”), and the United Stated Department of Energy (“DOE”).

During the course of the proceeding, Staff proposed various adjustments and changes to the Company’s proposed revenue requirement. The Company accepted some of Staff’s adjustments and Staff withdrew others. A summary of Staff’s final revenue requirement recommendations to the Commission in this proceeding is attached hereto as Appendix A. Also attached to this brief is Appendix B which contains Staff’s recommended changes to the Rate DSPP formula rate schedules and appendices.

Evidentiary hearings were held in this matter in Chicago on March 7-9 and 12-13, 2012.

II. OVERALL REVENUE REQUIREMENT

Based upon current revenues of $2,212,979,000, the Company proposed a revenue decrease of $57,037,000 which would result in a proposed revenue requirement of $2,155,942,000 (a 2.58% decrease from existing revenues). (Staff Ex. 13.0, Schedule 13.05, lines 2 through 4; Appendix A, Schedule 5, lines 3 through5).

However, based upon the analysis of its various witnesses, Staff proposes additional downward adjustments totaling $87,100,000 which would result in a revenue decrease of $144,137,000 for the Company and a proposed revenue requirement of $2,068,842,000 (a 6.51% decrease from existing revenues). (Appendix A, Schedule 5 lines 3 through 5)

III. RATE BASE

A. Overview

B. Potentially Uncontested Issues

1. Plant-in-Service

a. 2010 Distribution Plant

b. 2010 General and Intangible Plant, Other Than Functionalization (see III.C.2.b)

2. Accumulated Deferred Income Taxes

a. SERP (see also V.b.8)

The Commission should adopt the AG/AARP recommendation to offset the deferred tax debit balance related to the supplemental employee retirement plan (“SERP”) against the deferred tax credit balance in the calculation of the pension funding cost included in pro forma expenses, rather than directly included in rate base. (AG/AARP Ex. 2.0R, pp. 6-7) The Company agreed with and adopted the AG/AARP proposal. (ComEd Ex. 13.0, p. 11) Subject to Staff's recommendations regarding pension cost and pension asset stated herein, Staff does not oppose this treatment.

b. 401(k) Matching

The Commission should adopt the Staff and Company recommendation to include the ADIT associated with the 401(k) match in rate base without inclusion of the associated reserve. Unlike the situations with accrued incentive pay and accrued vacation pay discussed below, there is not a constant, long term balance associated with the reserve for 401(k) match. As such, there is not a constant, long term, non-investor source of funds that should be deducted from rate base. (Staff Ex. 16.0, p. 23) As a result of the Company's agreement that it was appropriate to include funds provided by the 401(k) matching accrual in rate base via its cash working capital analysis (see C.4.f. below), the inclusion in rate base of ADIT associated with the 401(k) match is no longer a contested issue.

3. Materials & Supplies Inventories

4. Regulatory Assets & Liabilities

a. Regulatory Assets

Section 16-108.5(c)(4) of the Act provides that the formula rate shall permit and set forth protocols, subject to a determination of prudence and reasonableness consistent with Commission practice and law, for the recovery of existing regulatory assets over the periods previously authorized by the Commission. (220 ILCS 5/16-108.5(c)(4)) Staff's testimony presents no adjustment to the existing regulatory assets amortized over the periods previously authorized by the Commission. Staff recommends that the Commission find the amount for the recovery of the identified existing regulatory assets over the periods previously authorized by the Commission is prudent and reasonable. (Staff Ex.4.0, p. 7)

b. Asset Retirement Obligation

c. Deferred Credits

The Commission should adopt the Company's rebuttal position to allocate the deferred credit arising from the lease of fiber optic equipment (and related revenues) using the Company's Communications Equipment Allocator. The Company proposed this allocation in response to the AG/AARP recommendation to allocate the amount using the Net Plant Allocator. (ComEd Ex. 13.0, pp. 14-15) Staff and AG/AARP concur with the Company's decision, and this is no longer a contested issue. (Staff Ex. 16.0, p.32; AG/AARP Ex. 4.0, p. 8)

d. Other Deferred Charges

5. Customer Deposits, Including Staff Proposal Re Interest (see also V.B.2)

Staff proposed an adjustment to reclassify the interest accrued on customer deposits from the Company's rate base (App. 2) to the operating statement (App. 7). (Staff Ex. 4.0, p. 2) The Company accepted Staff's adjustment in rebuttal testimony and reflected the interest on customer deposits on ComEd Ex. 13.1, App. 7, line 19. (ComEd Ex. 13.0, p. 16)

6. Customer Advances

7. Accumulated Depreciation & Amortization (Other than Derivative Impacts)

Staff adopted the approach to calculating depreciation expense and accumulated depreciation set forth in ComEd Ex. 12.0, Ex. 12.5.[1] Further, Staff agreed that its adjustments to accumulated depreciation and depreciation expense presented in ICC Staff Ex. 16.0, Sch. 16.04 is duplicative of the calculations included in ICC Staff Ex. 16.0, Sch. 16.01,[2] and as such, Staff withdrew the adjustment set forth on its Schedule 16.04. (ComEd-Staff Group Cross Ex. 1, p. 19) This is no longer a contested issue.

8. Non-AFUDC Construction Work in Progress

The Commission should adopt Staff's adjustment to remove specific non-AFUDC[3] construction work in progress ("CWIP") amounts from 2010 rate base, as those amounts were also included in the balance of 2011 projected plant additions. (Staff Ex. 5.0, p. 7) Staff argued that including non-AFUDC CWIP projects in both 2010 rate base and 2011 projected plant additions would overstate the rate base used in developing the forecast revenue requirement (*Id.*, p. 8), and that adjustments to include in the revenue requirement amounts that are proxies or reasonable representations of what can be expected to exist in the future, such as the inclusion of non-AFUDC CWIP in the forecast revenue requirement, are not appropriate in this proceeding. (Staff Ex. 16.0, p. 11) However, Staff acknowledged that non-AFUDC CWIP is a real cost of providing delivery service, and it should be recovered accordingly. During the reconciliation process, non-AFUDC CWIP should be included as a component of the year's actual cost. (*Id.*, p. 13) In surrebuttal testimony, the Company agreed with Staff's position. (ComEd Ex. 21.0, p. 15) This is no longer a contested issue.

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[1] ComEd Ex. 12.5 was subsequently updated. The updated version, which was also accepted by Staff, was entered into the evidentiary record as ComEd-Staff Group Cross Ex. 1, pp. 10-13.

[2] Staff Ex. 16.0, Sch. 16.01 was subsequently updated. A revised schedule, 16.01R, was entered into the record as ComEd-Staff Group Cross Ex. 1, pp. 5-9.

[3] AFUDC is an acronym for "Allowance for Funds Used During Construction."

C. Potentially Contested Issues

1. Average Year or End of Year Rate Base (see also VIII.C.1)

As discussed in more detail in section VIII.C.1 below, the Commission should adopt the Intervenor and Staff proposals to use average rate base to calculate what the revenue requirement would have been if the actual cost information for the applicable calendar year had been available at the filing date in the annual reconciliation as provided for in subsections 16-108.5(c)(6) and 16-108.5(d)(1) of the Act. Average rate base is more representative of the actual plant balances in service throughout the year, and more closely matches actual costs incurred during the year (e.g., depreciation expense) to the actual plant in service during the year. Further, an average rate base more closely matches actual capital investment in plant and associated return requirements during the year to the other expenses being incurred during the year. (Staff Ex. 16.0, pp. 33-35)

2. Plant-in-Service

a. Original Cost Finding 2010 Plant

The Commission should adopt Staff's recommendation to unconditionally approve $14,398,674,000 as the Original Cost of Plant in Service as of December 31, 2010, as presented on Staff Ex. 16.0, Sch. 16.05, which includes the impact on original cost of Staff's adjustments proposed in this proceeding. (Staff Ex. 16.0, pp. 19-20) Should the Commission make any additional adjustments to plant, those additional adjustments should also be considered in the original cost determination. Further, the Commission should include the following language in the Findings and Orderings paragraphs of its Order in this proceeding:

> (#) The Commission, based on ComEd's proposed original cost of plant in service as of December 31, 2010, before adjustments, of $14,426,332,000, and reflecting the Commission's determination adjusting that figure, unconditionally approves $14,398,674,000 as the composite original cost of jurisdictional distribution services plant in service as of December 31, 2010.

b. 2010 General and Intangible Plant Functionalization

The Commission should adopt Staff witness Bridal's adjustment to reduce the overall balance of distribution-related general and intangible ("G&I") plant and corresponding depreciation expense and accumulated depreciation amounts as a result of changes to the allocation of specific G&I plant accounts, proposed by Staff witness Rukosuev, discussed below. (Staff Ex. 16.0, p. 14)

i. Methodologies

ComEd's proposal to change the way it currently functionalizes its General Plant (FERC Accounts 389-399) and Intangible Plant (FERC Accounts 301-303) ("G&I Plant") lacks merit and should be rejected by the Commission.

G&I plant falls into the category of common costs, which are costs that serve multiple utility functions. The current functionalization approach uses a combination of generic functional allocators and direct assignments and has been approved previously by the Commission in Docket Nos. 10-0467, 08-0532, 07-0566 and 05-0597.

ComEd proposes to switch from a set of generic functional allocators to a single generic functional allocator of Wages and Salaries ("W&S") for certain G&I accounts (i.e., FERC Accounts 389-390, 392, and 394-396). For other G&I accounts (i.e., FERC Account 303, and to some extent 389-390), ComEd proposes to replace the direct assignment methodology with a general W&S allocator. (Staff Ex. 10.0, p. 10) Staff opposes these changes because ComEd has failed to present a cost-based justification for these proposals. (*Id.*, p. 11)

The functionalization process allocates assets and expenses between the Company's Illinois-jurisdictional distribution function and the Federal Energy Regulatory Commission ("FERC")-jurisdictional transmission function. Proper functionalization would result in the Commission setting rates on facilities that perform local distribution functions while FERC sets rates on facilities that transmit power in interstate commerce. (*Id.*, p. 9)

ComEd proposes a new allocation approach that places much greater reliance on general allocators for determining the distribution functions' share of these costs. While ComEd continues to directly assign the largest G&I plant Account, Account 397, using the same direct assignment study methodology that was approved for this Account in Docket Nos. 10-0467, 08-0532, 07-0566 and 05-0597, ComEd proposes to functionalize the remaining G&I plant accounts using a general labor allocator instead of using a mix of general allocators and other methods approved by the Commission in prior Commission proceedings. The W&S allocator proposed in this proceeding is the same allocator that ComEd proposed, and the Commission rejected less than a year ago, in Docket No. 10-0467. (*Id.*, p. 10) ComEd's proposed functionalization of G&I Plant costs in this proceeding is based on insufficient evidence and also conflicts with the Commission conclusion regarding this exact issue in Docket No. 10-0467. As the Commission stated in its Docket No. 10-0467 Order:

> ComEd contends that use of the new procedure is inconsequential, as if the previous methods for functionalizing General and Intangible plant had been used, it would have only been about 1.2% lower than the $1,280,718,000 gross plant that ComEd seeks here … [t]he Commission agrees with Staff that these proposed changes should be rejected. ComEd proffers no reason that justifies imposing this additional cost upon ratepayers. The Commission does not approve ComEd's proposed new accounting procedures.
> (Order, Docket No. 10-0467, May 24, 2011, pp. 41-42)

In contrast, Staff proposes to functionalize G&I Plant based on the allocators that the Commission has time and again found to be reasonable for ratemaking. In the instant proceeding, Staff's conclusion is shared by the AG and CUB. (*See* AG-AARP Ex. 1.0, pp. 39-45; AG-AARP Ex. 3.0, pp. 29-33; CUB Ex. 1.0, pp. 22-25; CUB Ex. 3.0, pp. 35-38)

As set forth in the Company's response to Staff Data Request PR 3.02, ComEd's alleged justifications for the change in G&I Plant allocation are as follows: 1) it aligns with the method used by FERC in ComEd's Transmission rates which also incorporates a W&S allocator for G&I plant; 2) it provides a more straightforward streamlined approach which is consistent with the overall objective of a formula rate; and 3) it is a reasonable cost-based method. (Staff Ex. 10.0, p. 11)

The Company's rationale is problematic for two reasons. First, the purpose of delivery service ratemaking is not to identify cost causation between the two jurisdictions - transmission and distribution. (*Id.*) Rather, it is to identify a cost-based functional allocation to the distribution function only. The focus is on cost, not achieving consistency with the functionalization of transmission costs. Second, the Company has failed to demonstrate that its proposed approach is, in fact, consistent with the transmission formula rate. Neither ComEd witnesses Mr. Tenorio nor Ms. Houtsma explain the mechanics behind the assertion that there will be no overlaps or gaps using the proposed methodology. (*Id.*, p. 12) Regardless of how the transmission allocation is determined, ComEd must still demonstrate that its proposed allocator for distribution is cost-based.

The Commission, and Staff for that matter, are limited in terms of time, particularly in this immensely complex Formula Rate proceeding, in ensuring that the costs between two jurisdictions are neither over-recovered nor under-recovered, especially where, as here, the documentation and data provided by ComEd for the FERC jurisdiction is incomplete. ComEd has the burden of proof to demonstrate that its proposed jurisdictional allocation of costs is reasonable. ComEd improperly shifts that burden to Staff and interveners. (Staff Ex. 21.0, p. 4)

Furthermore, the Company claims that the Commission conclusion rejecting ComEd's proposed methodology in Docket No. 10-0467 (which is identical to ComEd's proposal in this case) does not provide a sound reason to reject ComEd's proposal in this case, stating that:

> … [C]omEd made the same proposal in the 2010 rate case, but the record was very incomplete ... [s]o, the ICC did not have before it both sides of the issue. The ICC should decide the issue based on the additional facts now before it.
> (ComEd Ex. 12.0, pp. 29-30)

The burden is on ComEd to demonstrate that the Commission's conclusion in Docket No. 10-0467 is not applicable to the present proceeding. ComEd did not make such a demonstration. The "new additional facts" (ComEd Ex. 12.0, p. 30) presented by ComEd on this issue amounted to a collection of documentation without coherent cost-based justification of the proposed changes. Rather than providing cost based support to its revised functionalization approach, ComEd simply stated that the labor allocator represents a reasonable alternative foundation for functionalizing G&I plant in this proceeding, purportedly without sacrificing accuracy. (ComEd Ex. 2.0, p. 29) In other words, ComEd claims that its proposed alternative is “reasonable.” However, the Company fails to provide any basis as to why the Commission should change from the currently approved approach.

ComEd’s proposed approach is less accurate than the current method. The proposed approach uses more general allocators and less direct assignments for the allocation of these costs. (Staff Ex. 10.0, p.13) Indeed, allocation methods unavoidably employ the exercise of judgment; where there are no direct measures of cost-causation, indirect proxies normally are developed and applied. Because the development of an indirect proxy is not an exact science, the Company must demonstrate that its approach bears a rational relationship to the costs being functionalized. The Company, however, did not make that required showing in this case. (Staff Ex. 21.0, p. 10)

The proposed change in allocation has a significant impact on ratepayers because it produces approximately an $18,197,000 increase in rate base in conjunction with a depreciation expense increase of $492,000, together corresponding to a net increase of $2,547,000 to the Company’s proposed revenue requirement. (Staff Ex. 10.0, p. 10) In ComEd’s Response to Staff Data Request PR 6.01, the Company revised its initial estimate of the revenue requirement impact and stated that the overall net impact is a reduction to the revenue requirement of $2,171,000. (Staff Ex. 16.0, Attachment A, p. 1)

There is a clear incentive for ComEd to use functional allocators that would allow it to benefit. Given ComEd’s tangible benefits from this change, ratepayers should not be penalized by a reallocation of G&I plant account balances to delivery services. ComEd’s proposed functionalization clearly conflicts with prior Commission decisions in Docket No. 10-0467 and prior cases. (Staff Ex. 10.0, pp. 14-15) In contrast, Staff’s proposed decrease to ComEd’s revenue requirement in this proceeding is a direct result of consistently utilizing the Commission’s previously approved method for the entirety of G&I Plant accounts.

In sum, the Commission should continue to support the establishment of cost-based principles to the fullest extent possible. To do otherwise sends improper price signals. Any deviation from a cost basis should be supported by a compelling justification. The Company has not provided a compelling justification. (Staff Ex. 21.0, p.6) Therefore, Staff recommends the Commission reject ComEd’s proposed functionalization to G&I Plant and adopt the adjustments set forth in Staff Ex. 16.0, Schedule 16.03, resulting in a decrease to ComEd’s proposed revenue requirement of approximately $2,171,000 (See Staff Ex. 16.0, Attachment A, p.3)

ii. W&S Allocator Calculation (see also V.C.1.e)

The Commission should accept Staff’s calculation of the Wages and Salaries Allocator (W&S Allocator or A&G Allocator) because it includes all, one hundred percent, of ComEd’s 2010 FERC Form 1 reported wages and salaries in the denominator. ComEd’s calculation, on other hand, selectively excludes $1,432,396 of production wages and salaries from the denominator.

The W&S Allocator allocates the costs of administrative and general wages and salaries. These salaries provide support for all Company activities and, accordingly, are not directly assigned to specific cost centers. In general, the W&S Allocator or A&G Allocator determines how much of the Administrative Wages and Salaries expense should be allocated to delivery service customers. The Wages and Salaries Allocator is also used in numerous places in ComEd's Formula Rate Template to allocate other costs to the delivery service customers. The Company is proposing a W&S allocator of 89.22% that over-allocates $2.670 million in costs to the delivery service customers. (Staff Ex. 14.0, Attachment A, p. 1) Staff witness Knepler maintains that the allocator should be reduced by 0.50% (half of one percent) to 88.72%.

The Wages and Salaries Allocator can be depicted as the following:

$$\frac{\text{W\&S Directly Assigned to Delivery Service}}{\text{Total Wages \& Salaries}} \times \text{A\&G Wages Salaries} = \text{Amount Allocated to Delivery Service}$$

Both the Company and Staff agree that the numerator of the ratio should reflect wages and salaries directly assigned to Delivery Service. Thus, the numerator reflects: (1) Distribution, (2) Customer Accounts, and (3) Customer Service & Information wages and salaries. The disagreement lies in the components of the denominator. ComEd proposes that the denominator reflect all wages <u>except</u> $1,432,396 of production wages and salaries recorded in its 2010 FERC Form 1. (ComEd FERC Form 1, p. 354, line 3) Staff posits that the denominator of the W&S Allocator should include all wages and salaries paid by ComEd in 2010. (Staff Ex. 2.0, Schedule 2.02)

In Staff Data Request SRK-1.02(b), ComEd was asked to provide its rationale for excluding production expense, but including transmission expense in the calculation used to determine the denominator of the Wages and Salaries Allocator. ComEd's response essentially acknowledges that these are supply-related costs, but that it is more trouble than it is worth to assign them as such. ComEd's response states in part that:

> Considering that supply related salaries represent less that one-half of one percent of total ComEd salaries and wages, ComEd believes that the reassigning these non-directly assigned Administrative and General costs, ADIT and other costs to Rider PE would unnecessarily complicate the reconciliation proceedings for that Rider, and that such costs are more appropriately addressed in DST rates.
> (ComEd Response to Staff DR SRK-1.02(b); Staff Ex. 2.0, Attachment A)

Notwithstanding the fact that the issue is the development of an W&S Allocator and not the recovery of cost classified as production wages in ComEd FERC Form 1, ComEd appears to be telling distribution customers that: (1) this is a minor amount; and (2) the appropriate course of action is to continue to over-charge them by $2.670 million on an annual basis.

In rebuttal, ComEd fails to provide a substantive reason why production wages should be excluded from the denominator of the Wages & Salaries Allocator. ComEd witness Houtsma states that:

> Mr. Knepler, through the mechanical application of the Wages and Salaries allocator, is suggesting that 2.7 million dollars, or approximately one-half of one percent of a whole host of other corporate costs should also be assigned to these employees, and presumably recovered through Rider PE, rather than through the DST tariff.
> (ComEd Ex. 12, p. 20, 449-453)

Staff witness Knepler countered that his Schedule 2.02 (Staff Ex. 2.0) at column (b) demonstrates that the derivation of ComEd's proposed allocator is equally mechanical.

In her rebuttal, ComEd witness Houtsma also argues that if ComEd cannot recover the $2.670 million of costs from the distribution customers, then the Commission should allow it to recover these costs in Rider PE. (ComEd Ex. 14.0, p. 21, 478-481) However, addressing supply-related issues in this proceeding, as Ms. Houtsma suggests, would go beyond the scope of this proceeding. ComEd itself, when discussing supply-related uncollectibles, acknowledged that supply-related issues are beyond the scope of this proceeding. ComEd witness Dr. Hemphill states that "…supply charges, which are collected through tariffs not at issue in this proceeding and that are not formula delivery service rates. Supply-related uncollectible costs should be addressed outside of this proceeding as they are not related to delivery service." (ComEd Ex. 11.0, p 31, 651-654) ComEd witness Fruehe states that "Additionally, as Dr. Hemphill testifies in ComEd Ex. 11.0, Mr. Knepler's proposal as it relates to supply uncollectibles should be addressed outside of this proceeding." (ComEd Ex. 13.0, p. 39, 829-831) ComEd cannot have it both ways – it cannot exclude from this proceeding the supply related uncollectible expense as suggested by Dr. Hemphill and Mr. Fruehe but include the recovery of supply related A&G costs as recommended by ComEd witness Houtsma. In response, Staff witness Knepler states that it is possible that some costs could be shifted and recovered through Rider PE; however, supply charges recovered through Rider PE are not an issue in this proceeding. (Staff Ex. 14.0, p. 6, 105-107)

In surrebuttal testimony, ComEd witness Houtsma states that "The costs at issue here are indirect overhead costs that by their very nature <u>cannot be directly identified</u> as either production (supply), transmission, or distribution costs." (ComEd Ex 21.0, p. 16, 337-339, emphasis added) Staff agrees that administrative and general costs cannot be identified with a particular business segment or cost center and that the appropriate treatment is to apply the W&S allocator to such costs in order to determine the appropriate amount of cost assigned to delivery service. However, beginning at line 353, ComEd witness Houtsma then states that these costs are no longer unidentifiable, but "In my view, <u>these costs are incurred as a result of conducting ComEd's principal lines of business</u> – transmission and distribution – and should be appropriately split between those lines of business. (*Id.* p. 16, 353-355, emphasis added) Again, ComEd cannot have it both ways. The costs cannot be both: (1) costs that are unidentifiable with a particular business activity subject to an A&G allocator; and, also (2) costs that are identifiable with transmission and distribution. These two characterizations are mutually exclusive.

The decision of how ComEd should seek to recovery the $2.670 million of overcharges previously paid by the distribution customers is a decision left to the discretion of ComEd and best addressed by the Commission outside this proceeding. The Commission's mandate in this proceeding is to approve rates that "[p]rovide for the recovery of the utility's actual costs of delivery services that are prudently incurred and reasonable in amount consistent with Commission practice and law." (220 ILCS 5/16-108.5(c)(1)) The continued over-charging of delivery service customers is not a solution to ComEd's perceived problem. Staff further recommends that the Commission make a specific determination pursuant to Section 16-108.5(c)(4)(I) of the Act that a Wages and Salaries Allocation Factor of 88.72% is prudent and reasonable consistent with Commission practice and law. (Staff Ex. 14.0, p. 7)

c. 2011 Plant Additions

The Commission should adopt Staff's adjustments to remove certain projects from the Company's projection of 2011 plant additions (Staff Ex. 8.0, pp. 2-9; Staff Ex. 19.0, pp. 2-9), and to reduce the Company's aggregate forecast of 2011 plant additions. (Staff Ex. 5.0, pp. 3-7; Staff Ex. 16.0, pp. 3-9)

Subsection16-108.5(c)(1) of the Act states that the performance-based rate approved by the Commission shall [p]rovide for the recovery of the utility's actual costs of delivery services that are <u>prudently incurred and reasonable in amount</u> consistent with Commission practice and law. (220 ILCS 5/16-118.5(c)(1)) The Company provided with its formula rate filing 2011 projected plant additions, and Staff reviewed those 2011 projected plant additions for prudence and reasonableness consistent with Commission practice and law. Staff's review led to two separate and distinct adjustments: (1) Reductions to the amount of 2011 projected plant additions based on Staff's review of specific projects included within the Company forecast, and (2) Reductions to the total amount of 2011 projected plant additions based primarily on Staff's analysis of the Company's historical plant additions forecast accuracy.

Staff witness Yassir Rashid recommends that the Commission disallow $14,926,365 from ComEd's proposed rate base, which represents the cost of projects that ComEd either cancelled, completed subsequent to December 31, 2011 or put on hold, or categorized as transmission projects, as well as a project that ComEd indicated that it treats as a blanket program. (Staff Ex. 19.0, Attachment B, p. 3) Mr. Rashid recommends this adjustment because these projects were not used and useful on December 31, 2011 as required by Section 9-212 of the PUA (220 ILCS 5/9-212). Section 9-212, which is titled "New plant or facility or significant addition; inclusion in rate base," provides, in pertinent part:

> . . . A generation or production facility is used and useful only if, and only to the extent that, it is necessary to meet customer demand or economically beneficial in meeting such demand. No generation or production facility shall be found used and useful until and unless it is

> capable of generation or production at significant operating levels on a consistent and sustainable basis. . .
> (220 ILCS 5/9-212)

In addition, Mr. Rashid's direct testimony referenced Section 9-211 of the PUA (Staff Ex. 8.0, p. 3). Section 9-211 "provides that a utility's rate base may include 'only the value of such investment which is both prudently incurred and used and useful in providing service to public utility customers.'" Commonwealth Edison Co. v. Illinois Commerce Commission, 405 Ill.App.3d 389, 404 (2d Dist. 2010).

Staff's position, as set forth in Mr. Rashid's testimony, is that Section 9-212 clearly applies to significant additions to existing facilities or plant and accordingly would apply to distribution capital projects reviewed by Mr. Rashid. There should be no debate that Section 9-211 also applies to the distribution capital projects as well. In total Mr. Rashid reviewed information on eighty projects that ComEd included in rate base that were not complete before the end of 2011. Mr. Rashid contends that the cost of any project that ComEd did not include in its 2011 capital projects forecast should not be included in the calculation of the formula rate base. (Staff Ex. 19.0, pp. 7-8) Subsection 16-108.5(d)(1) of the PUA reads, in part:

> The inputs to the performance-based formula rate for the applicable rate year shall be based on final historical data reflected in the utility's most recently filed annual FERC Form 1 plus projected plant additions and correspondingly updated depreciation reserve and expense for the calendar year in which the inputs are filed.
> (220 ILCS 5/16-108.5(d)(1))

In the instant proceeding, the calendar year in which the formula rate inputs are filed is 2011. Therefore, it is appropriate as well as consistent with Subsection 16-108.5(d)(1) to only include data that is pertinent to ComEd's 2011 plant addition forecast in rate base. ComEd is responsible for providing an accurate forecast of its capital projects additions that may be reviewed to determine whether they are prudent and used and useful, which is the condition for including them in rate base.

The projects that Mr. Rashid reviewed include thirty-two projects that Mr. Rashid reviewed prior to filing his direct testimony; i.e. two projects that ComEd included in its Schedule F-4, which is part of ComEd's Part 285 filing in this docket; and the thirty most expensive projects following those included in the Schedule F-4. (Staff Ex. 9.0, pp. 5-6) In his direct testimony, Mr. Rashid concluded that the Commission should disallow the cost of four projects that ComEd did not complete before the end of 2011, as well as the cost of a project that ComEd cancelled, from inclusion in rate base. (*Id.*, pp. 7, 9) In addition, Mr. Rashid asked that ComEd state whether it included in its proposed rate base other projects with completion dates after the end of 2011 or that had been cancelled. Mr. Rashid sent ICC Staff DRs ENG 2.01 and ENG 2.02, which asked ComEd to identify projects that had been cancelled or had completion dates subsequent to the end of 2011. In response to these DRs, ComEd provided a supplemental response to ICC Staff DR ENG 2.01 (Staff Ex. 19.0, Attachment A), from which Mr. Rashid prepared Schedule 19.1 attached to his rebuttal testimony.

In its supplemental response to ICC Staff DR ENG 2.01, ComEd provided a list of seventy-nine distribution capital projects, seven of which are projects that it cancelled. (*Id.*) The cost of these cancelled projects is $1,316,739. (Staff Sch. 19.1, p. 2). The list included sixty-seven projects with completion dates subsequent to the end of 2011 or otherwise on hold. The cost of these delayed projects is $11,463,009. (Staff Sch. 19.1, p. 2). The list also included two projects that ComEd categorized as transmission projects that have a combined cost of $171,776. (Staff Sch. 19.1, p. 2). ComEd's supplemental response to ICC Staff DR ENG 2.01, however, did not include a project that has a completion cost of $1,974,541, which ComEd listed in its response to Staff DR ENG 1.01 with a completion date of Q4-2016. (Staff Ex. 19.0, Attachment B). ComEd names that project "O'Hare Modernization Project" and refers to it as ITN 13507. In its response to ICC Staff DR ENG 1.01, ComEd indicated that ITN 13507 is a long-term project that functions similar to a blanket project. (*Id.*, p. 3) ICC Staff DR ENG 1.01(d) asked ComEd to provide the completion cost of ComEd's 30 most costly additions to electric distribution plant, in addition to those already included on Schedule F-4. In her surrebuttal testimony, ComEd witness Michelle Blaise stated "While the overall project has a completion date of 2016, components of the project are completed and placed in service each year – including 2011." (ComEd Ex. 26.0, p. 5) However, Ms. Blaise failed to provide evidence that distinct components of ITN 13507 that are used and useful were put into service in 2011.

In his rebuttal testimony, Mr. Rashid updated the amount that the Commission should disallow ComEd from inclusion in rate base from $8,900,968, as recommended in his Direct Testimony, to $14,926,065. (Staff Ex. 19.0, p. 2)

ComEd asserts that the Commission should allow ComEd to recover the cost of distribution capital projects that it includes in rate base based on the overall plant additions regardless of whether ComEd originally included these projects in its 2011 projection for plant additions. (ComEd Ex. 17.0, p. 3-4) This contradicts Subsection 16-108.5(d) of the PUA, which specifically defines the inputs to the performance-based formula rate. Subsection 16-108.5(d) does not include the "overall plant addition" and specifically calls for inclusion of the projected plant additions. In addition, as discussed above, Section 9-211 of the Act states:

> The Commission, in any determination of rates or charges, shall include in a utility's rate base only the value of such investment which is both prudently incurred and used and useful in providing service to public utility customers.
> (220 ILCS 5/9-211)

Per Section 9-211 of the PUA, those projected plant additions should not be included if they are not used and useful.

The Commission should accept Mr. Rashid's recommendation to disallow $14,926,065 from inclusion in ComEd's proposed rate base.

Staff also reduced the total amount of projected plant additions requested by the Company based on a historical comparison of budgeted and actual plant additions using Year-to-Date ("YTD") actual information through October 2011. (Staff Ex. 16.0, p. 3) Staff's approach mirrors the Company's observation that "the goal of the projection should be to get the best *aggregate* forecasts…" (ComEd Ex. 20.0, p. 11) The historical information analyzed by Staff indicated that for the 70 month period covering calendar years 2006 through 2010 and January 2011 through October 2011, actual plant additions averaged only 96% of total budgeted plant additions (on a non-jurisdictional basis). Taking into consideration the magnitude of the historical variance[4] and the basis for the past and current plant additions forecasts (Staff Ex. 16.0, pp. 7-8), adjusting the projected plant additions to reflect the Company's historical variance between budgeted and actual plant additions provides a more reasonable projection of the expected additions to plant in service. (*Id.*, pp. 4-5)

The comparison of historical actual to budget plant additions provides the Commission an objective method of determining the reasonableness of projected plant additions, allowing the Commission to observe past trends independent of the analyses provided by the Company, and should not be dismissed. (*Id.*, p. 6) The Company itself acknowledges the necessity of such a review, stating "Clearly, projections of plant additions can and should be reviewed for reasonableness." (ComEd Ex. 26.0, p. 16) Further, the employ of this method to evaluate the reasonableness of the projected plant additions incorporates "multiple and dynamic considerations" ultimately relied upon in the Company's models, processes, and procedures used in developing its plant additions budgets. (ComEd Ex. 26.0, pp. 15-16; *Tr.*, March 8, 2012, at 331-333) As such, an analysis of the Company's historical forecast accuracy is illustrative of how its past forecasts have faired compared to actual results, and therefore should be used in the evaluation of future projections. (Staff Ex. 16.0, pp. 7-8)

Staff's review of the aggregate forecast did not consider the amount of actual plant additions placed into service by the Company by December 31, 2011. The fact is that the current proceeding is the only such formula rate proceeding in which ComEd's entire projected plant additions period (Calendar Year 2011) has expired. This is the only such proceeding in which the actual amount of ComEd projected plant additions will be known before rates utilizing the projection are effective. (Staff Ex. 16.0, p. 7) As such, Staff's review of the aggregate forecast utilized only information of a type which could be reasonably expected to be available during future proceedings.[5] This enabled Staff to focus on developing a process to evaluate the aggregate forecast which could be employed by the Commission in not only the current proceeding, but also in similar future proceedings during which the actual amount of projected plant additions will not be available prior to the date of the final order. Using the actual data through October 2011 in combination with the historical data from calendar years 2006-2010,[6] Staff determined that the Company averaged only 96% of total budgeted plant additions

[4] For 2011, a 4% budget variance (100%-96%) would result in an overstatement of $23,049,000 ($576,236,000 x 4%).

[5] Staff used actual data through October of the forecast period (2011). It is reasonable to expect that similar data (i.e. 9-10 months actual) would be available in future formula rate proceedings where a final order would be issued prior to and rates would become effective on January 1 of the following year.

[6] Although no party took issue with the 5-year historical period used by Staff, the Company attempted to argue that 2009 was inappropriate for inclusion in the analysis. Staff's rebuttal of the Company position on 2009 data (as set forth in Staff Ex. 16.0, pp. 8-9) was not challenged.

historically. Considering in its entirety the information discussed above, adjusting the projected plant additions to reflect the Company's historical spending variance from budgeted plant additions provides a more realistic projection of the expected additions to plant in service. (*Id.*, p. 4) As such, Staff's adjustment should be adopted by the Commission.

d. Derivative: Restricted Stock

e. Derivative: Incentive Compensation

f. Derivative: Perquisites and Awards

3. Accumulated Depreciation & Amortization (Derivative Impacts)

The derivative impacts of Staff's adjustments are included within Staff's adjustments. Staff recommends the Commission adopt Staff's adjustments in their entirety. However, if in adopting Staff's adjustments the Commission amends Staff's adjustments or otherwise adopts other adjustments, the derivative impact of those changes or other adjustments on accumulated depreciation and amortization should be reflected in a manner consistent with the way in which the Commission decides those underlying issues.

4. Cash Working Capital Issues

The Commission should accept Staff's modifications to the Company's cash working capital calculation ("CWC") as is consistent with the Commission's most recent Order in Docket No. 10-0467.

a. Revenue Collections Lag

Staff reduced CWC by using zero lag days for Energy Assistance/Renewable Energy Charges ("EAC/REC") and Gross Receipts / Municipal Utility Taxes ("GRT/MUT") (Staff Ex. 3.0, p. 4) consistent with the Final Order in Docket No. 10-0467. The Order states:

> The Commission agrees with Staff's interpretation as to the EAC/REC and GRT/MUT tax issues. For the EAC/REC tax, the utility shall remit all moneys received as payment to the Illinois Department of Revenue by the 20th day of the month following the month of collection. Under the GRT/MUT tax, this ordinance requires ComEd to file a monthly tax return to accompany the remittance of such taxes, due by the last day of the month following the month during which such tax is collected. Both the statute and ordinance requires ComEd to remit these pass-through taxes after they have been collected from customers. ComEd stated in its briefs that the Company correctly pays these taxes in the month following

> activity that occurs in a prior "tax liability" month. The Commission concludes that the CWC calculation for GRT/MUT pass-through taxes should reflect zero revenue lag days and 44.21 expense lead days and zero revenue lag days and 35.21 expense lead days for EAC/REC pass-through taxes as supported by Staff.
> (Order, Docket No. 10-0467, May 24, 2011, p. 48.)

EAC/REC and GRT/MUT are pass-through taxes. Pass-through taxes are just that: they pass through the utility on their way from the taxpayer, the ratepayer, to the taxing authority. (Staff Ex. 3.0, p. 5) Pass-through taxes are not revenue to the utility and are not included in the revenue requirement. (*Id.*) A revenue lag should not be applied to things which are not revenue. (*Id.*, p. 6)

CWC is intended to be the amount of funds required from investors to finance the day-to-day operations of a utility. (*Id.*, p. 3) Pass-through taxes are not part of the day-to-day utility operations which is the provision of utility service. (*Id.*, p. 6) Passing taxes from the ratepayer to the taxing authority, even if done through the ratepayer's monthly utility bill, does not change the nature of pass-through taxes. The method by which pass-through taxes are passed along does not transform them into a source of revenue for the utility.

Applying a revenue lag to pass-through taxes increases CWC, thereby increasing rate base. The result is that ratepayers would pay a higher rate to finance pass-through taxes, even though pass-through taxes are funded by ratepayers. (*Id.*)

The Company's inference that a Commission decision regarding the calculation of CWC would somehow lead ComEd into changing its internal procedures for remitting pass-through taxes is a straw man. (ComEd Ex. 16.0, pp. 19-20) Staff is not proposing that the Company change its internal procedures. (*Tr.*, March 8, 2012, p. 235) Staff's position affects only the amount of CWC to be included in rate base. Staff's position is the same as that adopted by the Commission in the Company's prior rate case, Docket No. 10-0467, and the Company did not change its procedures for remitting pass-through taxes as a result of that decision. (*Id.*) The Company has not even discussed this subject with the City of Chicago or other municipalities. (ComEd Ex. 16.0, p. 20; *Tr.*, March 8, 2012, p. 235) The Commission should make its decision on information available in this proceeding. What the Company might or might not negotiate with the various taxing authorities in the future is too uncertain to be considered.

Staff also reduced CWC by using 36.04 lag days for the pass-through taxes Illinois Excise Taxes and City of Chicago Infrastructure Maintenance Fees rather than the 51.25 lag days used by the Company. (Staff Ex. 3.0, p. 4) Staff's lag days do not include the service lag of 15.21 days which is included in the Company's 51.25 lag days (51.25 – 15.21 = 36.04). The Final Order in Docket No. 10-0467 set lag days to 39.26 days for Illinois Excise Taxes and City of Chicago Infrastructure Maintenance Fees. (Order, May 24, 2011, Docket No. 10-0467, Appendix A, p. 17, lines 4 - 5) The lag of 39.26 days is equal to the operating revenue lag of 54.47 days less the service lag of 15.21 days.

b. Pass-Through Taxes

In Docket No. 10-0467, the Commission agreed with Staff's proposal to use zero revenue lag days for EAC/REC and GRT/MUT. The Company's process for collecting and remitting pass-through taxes has not changed since Docket No. 10-0467. (*Tr.*, March 8, 2012, p. 236) Given that, there is no reason for the Commission to reach a conclusion here different than that in Docket No. 10-0467.

In the current proceeding, the Company has argued that its election to remit pass-through taxes earlier than required justifies a revenue lag. However, ratepayers should not be penalized for decisions made by the Company for its own benefit. (Staff Ex. 15.0, p. 4) The Commission should not accept the Company's argument as a reason to increase the Company's CWC. Given the hypothetical example of the Company electing to pay pass-through taxes a year earlier than required, Company witness Mr. Hengtgen testified that he would not expect the Commission to include the full year in the CWC calculation. (*Tr.*, March 8, 2012, p. 224) The principle of adding one month or one year to revenue lag because of the Company's election to remit early is the same: the only difference is the length of time. The Commission should not allow a revenue lag for EAC/REC and GRT/MUT because it only penalizes the ratepayers a little.

c. Intercompany Billing Lead

Staff reduced CWC through a higher number of expense lead days on intercompany obligations consistent with the Final Order in the Company's most recent rate case, Docket No. 10-0467. The Company's process for paying intercompany obligations has not changed since Docket No. 10-0467. Given that, there is no reason for the Commission to reach a conclusion here different than that in the Company's most recent rate case. (Staff Ex. 3.0, pp. 14-15)

The Commission should maintain its prior finding increasing intercompany billing lead by 15 days to equate inter-company billings as being paid 30 days after the month of service. The Company calculates the 30.55 day expense lead for intercompany obligations by combining a service lead and a payment lead of approximately 15.21 days and 15.33 days respectively. (ComEd Ex. 8.0, p. 15) Staff's analysis shows that the Company has an average payment lead of 55.04 days for its operation and maintenance services vendors. The Company uses a payment lead of 15 days for intercompany obligations which is less than one-third of the 55.04 day payment lead the Company used for its operation and maintenance services vendors. (Staff Ex. 3.0, p. 13) Allowing the Company to charge ratepayers a higher CWC requirement in order to pay the Company's affiliates earlier than non-affiliated vendors are paid is a form of cross-subsidization. Ratepayers would be penalized through higher costs (in the form of higher CWC) for services provided by ComEd affiliates.

In Docket No. 10-0467, the Commission agreed with Staff's proposal to increase expense lead for intercompany obligations. The Order in Docket No. 10-0467 states:

> Finally, with respect to payments of intercompany obligations, ComEd has not shown the need to reject Staff's adjustments in this area. According to

> the Company's initial brief, ComEd's affiliate invoices it on a monthly basis, on time, and the invoices require payments on or around the 15th of the month following the provision of service. Staff's adjustment is based on this statement. There was no mention of an affiliate agreement to the contrary. Therefore, the Commission accepts Staff's proposed number of expense lead days of 45.35, based on the fact that such payments are within the Company's discretion.
> (Order, Docket No. 10-0467, May 24, 2011, p. 48.)

d. Employee Benefits – Pension and OPEB Lead

AG/AARP witness Mr. Brosch and CUB witness Mr. Smith proposed using zero revenue lag days for a portion of operating revenue equal to Employee Benefits-Pension and OPEB in the CWC calculation. ComEd witness Hengtgen proposed using the revenue lag of 51.25 days that is used for operating revenue.

Staff has adopted Mr. Hengtgen's position of 51.25 revenue lag days for operating revenue; including the amount equal to Employee Benefits-Pension and OPEB in the CWC calculation. (Staff Ex. 15.0, Schedule 15.1 Revised, p. 1, line 1) Operating revenue lag is not a function of any of the operating expense leads. Expense leads for the various operating expenses are calculated independently of revenue lag and can be positive, negative or zero.

e. Accounts Payable Related to CWIP

The method of calculating the effect of Accounts Payable Related to CWIP in the rebuttal testimony of AG/AARP witness Brosch (AG/AARP Ex. 3.4, line 26) mirrors that of ComEd witness Hengtgen's surrebuttal testimony (ComEd Ex. 25.1, line 39). They differ slightly, however, on the amount of Accounts Payable Related to CWIP to include in the calculation. CUB witness Smith also proposes using the average 2010 Accounts Payable related to jurisdictional distribution CWIP in the CWC calculation (CUB Ex. 3.0, lines 252-255). Mr. Smith, however, proposed a different amount to include in the CWC calculation.

Staff has adopted Mr. Hengtgen's position on the amount of Accounts Payable Related to CWIP to include in the CWC calculation (Staff Ex. 15.0 Schedule 15.1 Revised, p. 1, line 33). (*Tr.*, March 12, 2012, p. 585) Staff believes that Mr. Hengtgen's amount best approximates the amount of vendor supplied financing.

f. 401(k) Match

In their rebuttal testimony, AG/AARP witnesses Effron and Brosch proposed an adjustment to CWC based on a longer lead time for a portion of the 401(k) match amount. (AG/AARP Ex. 3.0, lines 62-68; AG/AARP Ex. 4.0, pp. 2-3) In his surrebuttal testimony, ComEd witness Hengtgen agreed with Mr. Effron's and Mr. Brosch's proposal but with a different amount for the 401(k) match. Mr. Hengtgen's amount for the 401(k) match includes only the non-capitalized portion of the 401(k) match. (ComEd Ex. 25.0, pp. 20-21)

Staff has adopted Mr. Hengtgen's position on the amount of the 401(k) match to include in the CWC calculation which excludes the capitalized portion. (Staff Ex. 15.0 Schedule 15.1 Revised, p. 1, line 21)

g. Impact of Current and Deferred Taxes

Staff's CWC calculation includes all cash operating expenses included in the revenue requirement; State and Federal income tax expenses among them. (Staff 13.01, column (i), lines 19 and 20; and Staff Ex. 15.01 Revised, p. 1, column (b), lines 26 and 27) The Company, however, proposes to offset operating revenue with State and Federal income tax expenses in their CWC calculation. The Company proposes offsetting the income tax expenses because they are negative in the revenue requirement. (ComEd Ex. 16.0, p. 31)

Staff's proposal better represents the Company's CWC. Staff's CWC calculation includes negative current income tax expenses which represent a benefit to the Company attributable to the current period; thus their inclusion in the revenue requirement. Staff's CWC calculation is consistent with prior Commission practice of including all cash operating expenses included in the revenue requirement. The Final Order in the Company's most recent rate case, Docket No. 10-0467, included negative Federal income tax expense which increased CWC. (Order, May 24, 2011, Docket No. 10-0467, Appendix A, p. 17, line 27) That same appendix, on line 30, includes Illinois Excise Tax that, while positive, has a positive expense lead which also increased CWC.

Staff's CWC calculation is also balanced with receipts and outlays being nearly equal. (Staff Ex. 15.0 Schedule 15.1 Revised, p. 1, column (b), lines 6 and 32) Negative income taxes are included in the revenue requirement with the net effect of reducing total operating expenses. The reduction in total operating expenses results in a reduction of operating revenue. There is no need to manufacture an adjustment of revenue or expense in the CWC calculation. The Company's proposal arbitrarily increases revenue and expense in the CWC calculation which results in an increase in CWC. In Staff's proposal, CWC related to income tax expenses is calculated using the income tax expense lead of 37.88 days (Attachment A, Schedule 6, lines 26 and 27). The Company's proposal removes the negative income taxes from operating expenses in the CWC calculation and adds that same amount to operating revenue. The Company's proposal would increase CWC by $9,147,000 by applying 51.25 revenue lag days to the amount of negative income tax expense instead of applying the income tax expense lead of 37.88. The difference in the tax expense lead and revenue lag is 13.37 days (51.25 – 37.88). The $9,147,000 increase is calculated as ($33,825,000 * 13.37 / 365) + ($215,892,000 * 13.37 / 365).

h. ComEd Proposal re Timing of Future Lead/Lag Study

AG/AARP witness Brosch and IIEC witness Gorman both recommended that ComEd be required to undertake a new study for estimating its CWC. (AG/AARP Ex. 1.0, p. 28; IIEC Ex. 1.0, pp. 28-29) Staff did not take issue with the Company's revenue lag calculation and has no reason to endorse a study or investigation of the timing of customers' actual remittances or the Company's collection lag (AG/AARP Ex. 1.0, p. 28

and IIEC Ex. 1.0-C, pp. 28-29). The Company's method of calculating payment lag is consistent with the Commission's practice in this matter. (ComEd Ex. 16.0, p. 7)

5. Accumulated Deferred Income Taxes

a. 2011 Plant Additions

The Commission should find that Accumulated Deferred Income Taxes ("ADIT") on 2011 projected plant additions is not appropriate for inclusion in the determination of the delivery services rates set by the performance-based formula rate, as recommended by Staff and the Company. (Staff Ex. 16.0, p. 21)

Although inclusion of ADIT on 2011 projected plant additions in the forecast revenue requirement may narrow the gap between forecasted and actual 2012 rate base, such an adjustment is not specifically contemplated by the Act. Subsection 16-108.5(c)(6) and subsection 16-108.5(d)(1) of the Act specifically provide for the use of the most recently filed FERC Form 1, plus projected plant additions and correspondingly updated depreciation reserve and expense. The Act is silent regarding correspondingly updated ADIT. (Staff Ex. 16, p. 21) As such, Staff recommends that ADIT on 2011 projected plant additions not be included in the calculation of the forecast revenue requirement.

b. Bad Debt Reserve

The Commission should adopt the Intervenor and Staff adjustments to allocate ADIT associated with bad debt reserve to distribution services using the same method that was applied to the uncollectible expense that gave rise to that ADIT. The Company proposal to allocate ADIT associated with bad debt reserves 100% to distribution services should be rejected, as it would lead to ADIT associated with bad debts reserve being allocated differently from the bad debts that gave rise to the ADIT amount at issue.[7] (Staff Ex. 16.0, pp. 23-25)

ADIT arises from a timing difference between tax and financial treatment. In the case of bad debts, an ADIT debit balance is created when bad debt expenses are recorded for financial accounting purposes, but are not yet recognized as an expense for tax purposes. (AG/AARP Ex. 2.0, p. 4) Thus, there is a direct correlation between ADIT associated with bad debt reserve and bad debt expense.

AG/AARP and CUB argue that ADIT associated with bad debt reserve should be allocated using the same methodology as that used to allocate bad debts expense, because the two items are directly related. (AG/AARP Ex. 2.0. p. 4; CUB Ex. 1.0, p. 36) Staff agrees with the AG/AARP and CUB proposals. The Company failed to provide any valid reason why ADIT should not be assigned using the same method that was

[7] Bad debt expense that gave rise to ADIT on bad debt reserve was allocated by the Company to distribution services using the Revenue Allocator of 34.87%, as opposed to the 100% allocation proposed by the Company for ADIT related to Bad Debt Reserve. (Staff Ex. 16.0, p. 24)

applied to the uncollectible expense that gave rise to it. (Staff Ex. 16.0, pp. 23-25) Instead, the Company attempts to cloud the issue, arguing that the Intervenor positions are in direct contrast with their past positions on late payment charges, and also arguing that if not recovered in delivery services charges, the ADIT associated with bad debt reserve will not be recovered elsewhere. (ComEd Ex. 13.0, pp. 9-10) The Company also criticizes Staff and Intervenors for what the Company characterizes as a failure to address the discrepancy between the allocation of late payment charges and ADIT associated with bad debt reserve and failure to suggest alternatives of how ComEd should actually recover the ADIT cost. (ComEd Ex. 22.0, p. 9) These observations and criticisms are but a diversion intended to distract the Commission from its purpose in this proceeding.

As stated by AG/AARP and CUB, and endorsed by Staff, bad debt expense and ADIT associated with bad debt reserve are directly related, because bad debt expense gives rise to the ADIT amount. (Staff Ex. 16.0, pp. 23-25) Without the bad debt expense, there would not be ADIT on bad debt, and their direct relation is undisputed. Allocation of both amounts using the same methodology should be incontrovertible. However, the Company suggests that this approach is not appropriate because it will result in stranded costs not recovered via any other means. Staff does not contest the Company's observation – the record clearly shows that if the ADIT associated with bad debt reserve is not recovered 100% from delivery services, other tariffs in effect at this time for the Company (i.e. tariffs set in place by the Company itself) will not recover the shortfall. (ComEd Ex. 13.0, p. 10) However, this is not a valid reason to recover 100% of ADIT, or any cost, through delivery services. The fact that remaining ADIT costs will be unrecovered without changes to other Company tariffs, either under ICC jurisdiction or other jurisdiction, should have no bearing on this proceeding. The Commission is tasked with the responsibility of setting rates to allow the Company the ability to recover reasonable and prudent delivery services costs – not all costs. (220 ILCS 5/16-108.5(c)(1)) The Company itself determined that only 34.87% of bad debts expenses were appropriate for recovery via delivery services charges. (ComEd Ex. 22.1, App 7, Ln 26) It is reasonable that only 34.87% of the directly related ADIT be recovered via delivery services charges as well. The Staff and Intervenor adjustments to allocate ADIT associated with bad debt reserve using the same methodology as used by the Company to allocate bad debt expense which ultimately gave rise to the ADIT amount should be adopted by the Commission.

c. Vacation Pay

The Commission should include in rate base ADIT associated with vacation pay (after appropriate jurisdictional allocation), as recommended by Staff. (Staff Ex. 16.0, p. 26)

The Company originally included in rate base the delivery services jurisdictional ADIT debit amount associated with vacation pay. (ComEd Ex. 4.5, Sch B-9, Ln. 6) AG/AARP and CUB argued that if the ADIT debit amount associated with vacation pay was included in rate base, the accrued liabilities (reserve) that give rise to the ADIT should also be included in rate base. (AG/AARP Ex. 2.0R, p. 10; CUB Ex. 1.0, p. 35) However, in surrebuttal testimony, the Company accepted an AG/AARP alternative –

related to the AG/AARP proposal to include in rate base the Reserve for Accrued Vacation Pay (see C.6.a. below) – to remove from rate base the ADIT associated with vacation pay. (ComEd Ex. 22.0, pp. 10-11) Staff disagrees with the removal from rate base of the ADIT associated with accrued vacation pay, as the ADIT is appropriate for inclusion in rate base. (Staff Ex. 16.0, p. 26)

The Commission has consistently required that the entire balance of ADIT be included in rate base. In is Order in Docket No. 01-0432, the Commission stated:

> The Commission concludes that [the] entire balance of the reserve for deferred taxes should be deducted from rate base. The Commission agrees that selective adjustment for individual tax items creates an unneeded distinction among deferred tax accounts.
> (Order, March 28, 2002, Docket No. 01-0432, p. 24)

Further, in Docket No. 02-0798, 03-0008, & 03-0009 (Cons.), the Commission stated:

> The Commission agrees with Ameren that the entire balance of the reserve for deferred taxes should be deducted from rate base, without selective adjustment for individual items. The Orders cited by the Companies directly address the issue and support Ameren's position. (Order, October 22, 2003, Docket Nos. 02-0798, 03-0008 & 03-0009 (Cons.), p. 24)

The Commission should remain consistent with these prior orders, and find that the entire jurisdictional balance of ADIT, including jurisdictional ADIT associated with vacation pay, be included in rate base.

d. Incentive Pay

The Commission should include in rate base ADIT associated with incentive pay (after appropriate jurisdictional allocation), as recommended by Staff and the Company. (Staff Ex. 16.0, p. 26)

The Company included in rate base the delivery services jurisdictional ADIT debit amount associated with incentive pay. (ComEd Ex. 22.3, Sch. B-9, Ln. 11) CUB argued that some ADIT items that ComEd included in rate base, including ADIT associated with incentive pay, should not be included in rate base and are not consistent with the ratemaking treatment applied in the Company's last general rate case. (CUB Ex. 1.0, p. 27) AG/AARP and CUB also argued that the ADIT debit amount associated with incentive pay should not be included in rate base unless the accrued liabilities (reserve) that give rise to the ADIT is also included in rate base. (AG/AARP Ex. 2.0R, p. 10; CUB Ex. 1.0, p. 35) Staff disagrees with the removal from rate base of the ADIT associated with accrued incentive pay, as the ADIT is appropriate for inclusion in rate base. (Staff Ex. 16.0, p. 26)

The Commission has consistently required that the entire balance of ADIT be included in rate base. In is Order in Docket No. 01-0432, the Commission stated:

> The Commission concludes that [the] entire balance of the reserve for deferred taxes should be deducted from rate base. The Commission agrees that selective adjustment for individual tax items creates an unneeded distinction among deferred tax accounts.
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The Commission should remain consistent with these prior Orders and should find that the entire jurisdictional balance of ADIT, including jurisdictional ADIT associated with incentive pay, be included in rate base.

e. FIN47

The Commission should include in rate base ADIT associated with FIN 47 (after jurisdictional allocation), as recommended by Staff and the Company. (Staff Ex. 16.0, p. 26-27)

The Company included in rate base the delivery services jurisdictional ADIT debit amount associated with FIN 47. (ComEd Ex. 22.3, Sch. B-9, Ln. 60) CUB argued that some ADIT items that ComEd included in rate base, including ADIT associated with FIN 47, should not be included in rate base and are not consistent with the ratemaking treatment applied in the Company's last general rate case. (CUB Ex. 1.0, p. 27) The Company responded, arguing that ADIT associated with FIN 47 relates to plant removal costs, and because the operating reserve associated with plant removal costs recovered through depreciation expense is included as a reduction to rate base, the related ADIT is properly included in rate base. (ComEd Ex. 13.0, pp. 11-12) For the reasons stated by the Company, Staff agrees that the CUB recommendation to remove from rate base ADIT associated with FIN 47 should not be adopted.

In addition, the Commission has consistently required that the entire balance of ADIT be included in rate base. In is Order in Docket No. 01-0432, the Commission stated:

> The Commission concludes that [the] entire balance of the reserve for deferred taxes should be deducted from rate base. The Commission agrees that selective adjustment for individual tax items creates an unneeded distinction among deferred tax accounts.
> (Order, March 28, 2002, Docket No. 01-0432, p. 24)

Further, in Docket No. 02-0798, 03-0008, & 03-0009 (Cons.), the Commission stated:

> The Commission agrees with Ameren that the entire balance of the reserve for deferred taxes should be deducted from rate base, without selective adjustment for individual items. The Orders cited by the Companies directly address the issue and support Ameren's position. (Order, October 22, 2003, Docket Nos. 02-0798, 03-0008 & 03-0009 (Cons.), p. 24)

The Commission should remain consistent with these prior orders, and should find that the entire jurisdictional balance of ADIT, including jurisdictional ADIT associated with FIN 47, be included in rate base.

6. Operating Reserves

a. Accrued Vacation Pay

The Commission should adopt the Intervenor and Staff adjustments to include in operating reserves as a reduction to rate base the liability for accrued vacation pay. (Staff Ex. 16.0, pp. 27-29)

The lag between the vacation accruals and the cash payments creates a constant non-investor source of funds which should be deducted from rate base similar to other operating reserves. As shown on AG/AARP Exhibit 2.1, Schedule DJE-1.2, there is a constant balance of funds held in reserve. (Staff Ex. 16.0, p. 29) Additionally, AG/AARP and CUB argued that if the related ADIT balance is included in rate base, the related liability which gives rise to that ADIT should also be included in rate base. (AG/AARP Ex. 2.0R, p. 10; CUB Ex. 1.0, p. 35) In the case of the reserve for accrued vacation pay, a constant balance of non-investor funds are held in reserve; and as such the reserve for accrued vacation pay should be included in operating reserves as a reduction to rate base. (Staff Ex. 16.0, p. 29) The Company's revised cash working capital study separately accounts for vacation pay, thereby including the current liability related to vacation pay in rate base. (ComEd Ex. 13.0, p. 13) However, the Company has failed to account for the entire reserve, instead reflecting only a small portion in the total in rate base. Review of Staff's adjustment, which mirrors that of AG/AARP, clearly shows that the amount of reserve for accrued vacation pay accounted for in the Company's cash working capital study ($823,000) pales in comparison to the total reserve for accrued vacation pay ($440,042,000). (ComEd-Staff Group Cross Ex. 1, p. 16, Ln. 15-16) As such, Staff's adjustment appropriately includes the remaining amount of the reserve for accrued vacation pay in rate base that was not already included via the Company's cash working capital study.

As discussed in section III.C.5.c. above, the Company in surrebuttal testimony removed from rate base the ADIT debit balance associated with the reserve for vacation pay. Staff opposes the adjustment to remove the ADIT amount; however, the ADIT amount has no impact on Staff's position regarding the reserve for accrued vacation pay. Regardless of the treatment afforded ADIT, Staff maintains its position that in the case of the reserve for accrued vacation pay, a constant balance of non-investor funds are held in reserve; as such, the reserve for accrued vacation pay should be included in operating reserves as a reduction to rate base. (*Tr.*, March 13, 2012, pp. 831-832)

Staff's and AG/AARP's adjustments to include the reserve for accrued vacation pay in rate base should be adopted by the Commission.

b. Accrued Incentive Pay

The Commission should adopt the Intervenor and Staff adjustments to include in operating reserves as a reduction to rate base the liability for accrued incentive pay. (Staff Ex. 16.0, pp. 29-31)

The lag between the incentive pay accruals and the cash payments creates a constant non-investor source of funds which should be deducted from rate base similar to other operating reserves. As shown on AG/AARP Exhibit 2.1, Schedule DJE-1.2, there is a constant balance of funds held in reserve. (Staff Ex. 16.0, p. 31) Additionally, AG/AARP and CUB argued that if the related ADIT balance is included in rate base, the related liability which gives rise to that ADIT should also be included in rate base. (AG/AARP Ex. 2.0R, p. 10; CUB Ex. 1.0, p. 35) In the case of the reserve for accrued incentive pay, a constant balance of non-investor funds are held in reserve; as such, the reserve for accrued incentive pay should be included in operating reserves as a reduction to rate base. (Staff Ex. 16.0, p. 31) The Company's revised cash working capital study separately accounts for incentive pay and reflects a longer lead time, thereby including the short term liability related to incentive pay in rate base. (ComEd Ex. 13.0, p. 13) However, the Company has failed to account for the entire reserve, instead reflecting only a portion in the total in rate base. Review of Staff's adjustment, which mirrors that of AG/AARP, clearly shows that the amount of reserve for accrued incentive pay accounted for in the Company's cash working capital study ($18,152,000) is much less than the average reserve for accrued incentive pay ($28,553,000). (ComEd-Staff Group Cross Ex. 1, p. 18, Ln. 15-16) As such, Staff's adjustment appropriately includes the outstanding amount of the reserve for accrued incentive pay in rate base that was not already included via the Company's cash working capital study. The Staff and AG/AARP adjustments to include the reserve for accrued incentive pay in rate base should be adopted by the Commission.

7. Other

IV. REVENUES

A. Potentially Uncontested Issues

1. Correction to Lease/Rental Revenues

B. Potentially Contested Issues

1. Late Payment Charges Revenues Allocation

Staff did not take a position regarding the allocation of late payment charges revenues in this proceeding. However, Staff notes that the Commission's Order in

Docket No. 10-0467 adopted the AG/CUB proposal to allocate to delivery services all late payment charges that are not shown to be allocable to other jurisdictions. (Order, May 24, 2011, Docket No. 10-0467, pp. 303-306)

2. New Business and Billing Determinants

3. Other

V. OPERATING EXPENSES

A. Overview

B. Potentially Uncontested Issues

1. Distribution

2. Customer Accounts Expenses Other Than Uncollectibles, Including Staff Proposal re Interest on Customer Deposits (see also III.B.5)

Staff proposed an adjustment to reclassify the interest accrued on customer deposits from the Company's rate base (App. 2) to the operating statement (App. 7). (Staff Ex. 4.0, p. 2) The Company accepted Staff's adjustment in rebuttal testimony and reflected the interest on customer deposits on ComEd Ex. 13.1, App. 7, line 19. (ComEd Ex. 13.0, p. 16)

3. Uncollectibles Expense and Staff Rider Proposal

Staff proposed that uncollectible expense be removed from this and all future formula rate filings for the Company and that the expense recovery and related issues be addressed in Rider UF (Uncollectible Factors) proceedings. (Staff Ex 2.0, pp. 3-8) ComEd witness Dr. Hemphill stated that "If the Commission were to determine that Mr. Knepler's proposal does not change interclass cost allocation and, therefore, is consistent with the rates approved in Docket No. 10-0467, ComEd will not contest that position." (ComEd Ex. 11.0, p 31, 648-650) Dr. Hemphill's caveat is consistent with Staff's understanding of the issue. Therefore, given the agreement of the parties to recover delivery service uncollectible expense through Rider UF, Staff believes it would be appropriate for the Commission's final Order to state:

> Starting June 1, 2012 or when the rates from this proceeding become effective, all delivery service uncollectible costs should be recovered through Rider UF.

4. Customer Service and Informational Expenses

5. Adjustments for Ratemaking, Other Tariffs, Past Orders, and Other

6. Administrative and General Expenses

a. Regulatory Commission Expense

Staff proposed to reduce administrative and general expenses for regulatory commission expense previously recovered through ComEd's power procurement rider (Rider PE – Purchased Electricity). (Staff Ex 2.0, pp. 11-12; Staff Ex 14.0, p. 10) ComEd agreed to this correction in its rebuttal testimony. (ComEd Ex. 13.0, p. 41) This issue is no longer contested.

b. Transmission-Related Research and Development

Staff proposed to reduce administrative and general expense for the non-jurisdictional transmission related research and development costs that were inadvertently included in ComEd formula rate filing. (Staff Ex. 2.0, p. 12; Staff Ex. 14.0, p. 2) ComEd agreed to this correction. (ComEd Ex. 13.0, p. 41) This issue is no longer contested.

c. Sporting Event Activities

Staff proposed professional sporting activity expenses be removed from this formula rate filing. The Company indicated in response to Staff DR ST-1.01 that these expenses were inadvertently included in the proposed revenue requirement and agreed to the removal of these costs (ComEd Ex. 13, p. 41). This issue is no longer contested.

d. Outside Services

Staff proposed certain legal fees associated with an IRS dispute be removed from this formula rate filing. The Company indicated in response to CUB DR 2.05 that inclusion of these fees was an inadvertent oversight. ComEd agreed to remove these costs (ComEd Ex.13, p. 41). This issue is no longer contested.

e. Correction of Error Relating to Rider EDA

In response to Staff DR ST-3.02, the Company indicated that an accounting error led to a revenue requirement overstatement regarding legal fees associated with Rider EDA. ComEd agreed to correct this error (ComEd Ex.13, p. 41). This issue is no longer contested.

f. Photovoltaic Pilot Costs

7. Regulatory Asset Amortization: Unusual Operating Expenses, Including Storm Costs

Section 16-108.5(c)(4) of the Act provides that the formula rate shall permit and set forth protocols, subject to a determination of prudence and reasonableness consistent with Commission practice and law, for a single storm with costs exceeding $10 million as an unusual operating expense with amortization over a five year period. Staff's direct testimony did not take issue with the regulatory treatment of the June 18, 2010 storm costs that totaled $11.079 million. Staff recommends that the Commission find as prudent and reasonable costs of $2.216 million as an unusual operating expense and the unamortized storm costs of $8.863 million with deferred tax impact of ($3.523 million) which are reflected in rate base. (Staff Ex. 4.0, p. 6) This reflects the five-year amortization proposed by ComEd.

8. Pension Asset Funding – SERP ADIT Component (see also III.B.2.a)

As discussed in Section III.B.2.a above, subject to Staff's other recommendations regarding pension costs and pension asset stated here within, Staff does not oppose the inclusion of SERP ADIT in the calculation of pension funding cost as discussed in AG/AARP Ex. 2.0R, pp. 6-7 and ComEd Ex. 13.0, p. 11.

9. Income Taxes Other Than Interest Synchronization

10. Depreciation & Amortization Expense, Including Staff's Withdrawn Proposal Regarding a Future Study (Other than Derivative Impacts)

Staff adopted the approach to calculating depreciation expense and accumulated depreciation set forth in ComEd Ex. 12.0, Ex. 12.5. Further, Staff agreed that its adjustment presented in ICC Staff Ex. 16.0, Sch. 16.04 is duplicative of the calculations included in ICC Staff Ex. 16.0, Sch. 16.01. As such, Staff withdrew the adjustment set forth on its Schedule 16.01. (ComEd-Staff Group Cross Ex. 1, p. 19) This issue is no longer contested.

In addition, Staff witness Bridal included a proposal that the Commission require the Company to perform an updated depreciation study and consider the results of that study in its next formula rate filing or its next general rate filing if a formula rate filing is not filed following the final order in this proceeding. (Staff Ex. 5.0, pp. 13-14) However, because a new depreciation study will be performed by the Company every five years, (as required by the Order in Docket No. 07-0566), and an updated study is planned for 2013, Staff withdrew its recommendation that ComEd complete a new depreciation study. (Staff Ex. 16.0, pp. 16-17) This issue is no longer contested.

11. Staff Proposal for Finding Regarding Non-Inclusion of Rate Case Expense in Initial Rates

12. Gross Revenue Conversion Factor

C. Potentially Contested Issues

1. Administrative and General Expenses

a. Total

b. Restricted Stock

The Commission should accept Staff's proposed adjustment to disallow 100% of the cost of the Key Manager Restricted Stock Award since the objective of the plan is to further the financial and operational success of Exelon, not ComEd. Arguably, the financial success of Exelon is favorably impacted by ComEd rate increases. However, the Company has made no showing that Exelon's financial and operational success directly benefits ComEd ratepayers. The Commission has long held the standard that utilities must show that in order for incentive compensation to be recoverable, incentive compensation must benefit ratepayers. This is essentially the same standard reflected in Section 16-108.5(c)(4)(A) of the Act. (220 ILCS 5/16-108.5(c)(4)(A)) Because the Company has not demonstrated how this incentive program meets the criteria for incentive compensation recovery set forth in the protocols, these costs should be removed from the 2010 revenue requirement. Furthermore, these key managers are rewarded with restricted stock, which aligns the interests of the recipients with shareholders, not ratepayers. (Staff Ex. 1.0, p. 15, lines 276 – 285)

The Company claims that the goal of this program is retention of key employees which helps ensure the overall success of ComEd, and that ComEd's overall success largely depends on the ability to provide a high level of service to customers. (ComEd Ex. 13.0, p. 21, lines 440 – 443) The Commission considered the argument involving retention of employees in Docket No. 10-0467 when the Commission addressed the Perquisites and Rewards issue, agreeing with the AG and CUB. (Staff Ex. 1.0, p. 16, lines 304 – 317; Order, May 24, 2011, Docket No. 10-0467, p. 102) The Company has provided no new information to explain why the Commission should reach a different conclusion on recovery of the costs of the Restricted Stock Program than the Commission found in the last rate case. (Staff Ex. 13.0, p. 17, lines 387 – 394)

c. Incentive Compensation

The Commission should approve Staff's proposed adjustments to incentive compensation to:

a) Limit the Annual Incentive Pay ("AIP") to the net income limiter before applying the plan's CEO Discretionary feature.
b) Remove 75% of the incentive compensation costs allocated from the Business Services Company ("BSC").

Through exercising the AIP plan's CEO discretionary feature, ComEd applied funds that might have been paid out under the 2010 Long-Term Incentive Plan ("LTIP") Milestones to the AIP payouts. This transfer resulted in an increase in the net income limiter under the AIP plan to 112.9% from the initial net income limiter of 102.9%. The AIP actual performance resulted in a calculated payout percentage of 110.3%. Therefore, the CEO discretionary feature provided for AIP payout in excess of the initial net income limiter (110.3% rather than 102.9%). The net income limiter feature is deceiving since management can, at its discretion, increase that limit with board approval as it did by increasing the limiter to 112.9% from 102.9%. Shifting money from one plan to another with different performance metrics, and in effect circumventing "protections" that are built into the plan, renders those "protections" ineffective. (Staff Ex. 13.0, pp. 18-20) In surrebuttal testimony, the Company agrees that Staff's position is more reasonable than that of CUB witness Smith which cap's the AIP payout at 100%. (ComEd Ex. 22.0, p. 15, lines 323-324.)

AG/AARP witness Brosch and CUB witness Smith proposed to disallow 75% of the incentive compensation costs allocated from BSC. (AG/AARP Ex. 1.3, p. 4; CUB Ex. 1.2, Schedule C-9) The costs in question are tied to the earnings per share goal that is specifically disallowed from recovery under Section 16-108.5(c)(4)(A) which states in part:

> Incentive compensation expense that is based on net income or **an affiliate's earnings per share** shall not be recoverable under the performance-based formula rate.
> (220 ILCS 5/16-108.5(c)(4)(A) (emphasis added))

The Company argues that these BSC costs should be viewed on their overall reasonableness without regard to their individual components. (ComEd Ex. 13.0, p. 23, lines 484 – 489) This argument ignores the fact that affiliate interest transactions are given closer scrutiny than transactions with unrelated parties under the Act.

d. Perquisites and Awards

The Commission should disallow Perquisites and Other Awards as presented on Staff Exhibit 13.0, Schedule 13.10, consistent with the treatment approved in the prior rate case. In that case, the Commission agreed with the AG and CUB on the issue of Perquisites and other awards. (Order, May 24, 2011, Docket No. 10-0467, p. 103.)

> In the 2009 test year, a year with severe recession and high unemployment, ComEd exceeded the total it had spent on retention awards for the previous three years. Company policy is clear that management retains the right to modify or revoke its retention bonus policy at any time, but it chose not to do so during this tumultuous time. CUB asserts that ComEd has not explained why it was significantly more difficult to retain employees during this period of high unemployment than it was when the economy was healthier. Additionally, ComEd includes

> amounts from affiliates that are beyond the amounts provided for in the annual incentive plans.
> (Order, May 24, 2011, Docket No. 10-0467, p. 102.)

In rebuttal, the only new discussion provided by the Company was to propose revisions to Appendix 7 of the formula rate template. (ComEd Ex. 13.0, p. 30, lines 642 - 649) Staff does not oppose those revisions as they would make the recoverable amounts more transparent. (Staff Ex. 13.0, p. 21, lines 462 - 464)

e. W&S Allocator Calculation (see also III.C.2.b.2)

The discussion of the Wages and Salaries Allocator is presented in the Rate Base section of this initial brief (Section III.C.1.b.2).

f. Charitable Contributions

The Commission should accept Staff's proposed adjustment to disallow certain of the Company's Charitable Contributions. Staff's adjustment is two-fold. First, Staff's proposed adjustment disallows contributions that do not fall into one of the recoverable categories set forth in Section 9-227 of the Act. (220 ILCS 5/9-227) Second, Staff's proposed adjustment disallows a contribution made to the University of Wisconsin as it is outside of ComEd's service territory.

Regarding the categories set forth in Section 9-227 of the Act, Staff uses a narrower definition of the phrase *public welfare* than that used by the Company. The Company's interpretation of Section 9-227 is incorrect. Dr. Hemphill stated:

> As I understand it, Illinois utilities can recover contributions when they are: (a) for a "charitable, scientific, religious or educational purpose," and (b) reasonable in amount.
> (ComEd Ex. 11.0, p. 11)

The Company has erroneously included a comma after the word charitable when quoting Section 9-227 as noted in cross examination. (*Tr.*, March 13, 2012, p. 799) The effect of this misplaced comma incorrectly makes "charitable" its own category of recoverability. Based on the Company's flawed application of Section 9-227, any donation made to a charitable organization is recoverable through rates. This is incorrect. Section 9-227 only allows for recovery of donations that fall within certain categories. In order for a donation to be recoverable through rates, it must be to a charitable organization *and* it must be for scientific, religious, or educational purposes, or for the public welfare. (ICC Staff Exhibit 6.0, p. 3) The derivation of Staff's recoverable Charitable Contributions is presented on Staff Ex. 6.0, Schedule 6.01 and Staff Ex. 17.0, Schedule 17.01.

Second, Staff's proposed adjustment disallows a contribution to the University of Wisconsin because the university is an out-of-state university. Ratepayers should not be funding an out-of-state university over an in-state university. (ICC Staff Exhibit 6.0, pp. 2-3) Staff's adjustment is consistent with the Commission's most recent order for the

Company. (Docket No. 10-0467, May 24, 2011) ("The Commission concurs with Staff's proposal to disallow charitable contributions made by ComEd to organizations outside of the Company's service territory. There is no evidence that these contributions provide any benefit to ratepayers in ComEd's service territory. The Commission agrees with Staff that it is not reasonable to require ComEd ratepayers to bear the cost of such contributions. Accordingly, Staff's adjustment is adopted.") (*Id*., p. 108)

g. Advertising Expense

The Commission should accept Staff's proposed adjustment to disallow the Company's advertising costs which are goodwill in nature and incremental to the Company's historical expenditures for conservation of energy advertising. Section 9-225 of the Act specifically prohibits advertising which is designed primarily to bring the utility's name before the general public in such a way as to improve the image of the utility. (220 ILCS 5/9-225)

Staff identified several examples of advertisements that appear to be designed primarily to improve the Company's image. The advertisements prominently display the ComEd logo but only allude to any conservation of energy message or their message is displayed in a much smaller font than that of the Company's logo, which is in a more prominent position. (ICC Staff Exhibit 17.0, pp. 5-6)

In addition, with respect to energy efficiency advertising, the creation of Rider EDA was to, "recover all Incremental Costs incurred by the Company in association with Energy Efficiency and Demand Response Measures…" (ILL. C.C. No. 10, 1st Revised Sheet No. 245) Prior to the creation of Rider EDA, in 2006 the Company recorded $157,000 of conservation of energy advertising costs. In 2010 the Company's conservation of energy advertising costs were $2,800,000. These costs are incremental to what the Company has historically spent and should be considered for recovery through Rider EDA, not through the formula rates. (ICC Staff Exhibit 6.0, p. 8) The derivation of Staff's allowable Advertising Expense is presented on Staff Ex. 6.0, Schedule 6.02 and Staff Ex. 17.0, Schedule 17.02.

2. Depreciation and Amortization Expense (Derivative Impacts)

The derivative impacts of Staff's adjustments are included within Staff's adjustments. Staff recommends the Commission adopt Staff's adjustments in their entirety. However, if in adopting Staff's adjustments the Commission amends Staff's adjustments or otherwise adopts other adjustments, the derivative impact of those changes or other adjustments on depreciation and amortization expense should be reflected in a manner consistent with the way in which the Commission decides those underlying issues.

3. Taxes Other Than Income, Including Property Taxes

4. Regulatory Asset Amortization: IEDT

CUB Witness Smith proposes an amortization period of three years versus a five year amortization period for IEDT credits that ComEd used in the formula rate in accordance with Section 16-108.5 (c)(4)(f). Mr. Smith argues that the three years of IEDT credits that ComEd recorded in 2010, totaling $38.980 million, do not relate to any of the items required to be amortized over a five year period per Section 16-108.5 (c)(4)(f). Since there is no specific amortization period under the PUA for this item, the amortization should match the number of years of IEDT periods or three years. The three year amortization of the three years of tax credits is a better match and produces a more reasonable annual amortization amount. (CUB Ex. 3.0, pp. 27-29)

ComEd, in rebuttal testimony, acknowledged that Section 16-108.5 (c)(4)(f) does not specifically state that an IEDT credit related to credits yet to be received should be amortized over five years. Since the credits total of $38.980 million is in excess of $10 million and is a one time unusual adjustment, ComEd believes that the credit meets the spirit of the legislation and should be amortized over five years. (ComEd Ex. 13.0, p. 37) ComEd, in response to Staff DR JMO 4.01, also disclosed that the change in internal accounting practice to accrue three years of IEDT credits was not triggered by a change in rule, but that the impact of the accrual is similar to that of a change in accounting rule. As such, it is consistent with the criteria in Section 16-108.5 (c)(4)(F) for amortization of costs due to changes in accounting rules. Staff's direct testimony presents no adjustment to the amortized amount of IEDT credits, nor for the unamortized balance, and the deferred tax impact. Staff recommends that the Commission find as prudent and reasonable costs of ($7.796) million as an unusual operating expense and the unamortized IEDT credits of ($31.184) million with deferred tax impact of $12.394 million which are reflected in rate base. (Staff Ex. 4.0, p. 7) This reflects the five-year amortization proposed by ComEd.

5. Pension Costs

a. Pension Asset Funding

Under Section 16-108.5(c) of the Act, a participating utility may elect to recover its delivery services costs through a performance-based formula rate. (220 ILCS 5/16-108.5(c)) The performance based rate is, among other things, to provide for the recovery of the participating utility's actual costs of delivery services that are prudently incurred and reasonable in amount consistent with Commission practice and law. (220 ILCS 5/16-108.5(c)(1)) The performance based rate is also to permit and set forth protocols, subject to a determination of prudence and reasonableness consistent with Commission law and practice, for, among other things, an "<u>investment return on pension assets</u> net of deferred tax benefits equal to the utility's long-term debt cost of capital as of the end of the applicable calendar year." (220 ILCS 5/16-108.5(c)(4)(D)(emphasis added))

Staff's position set forth in Ms. Ebrey's testimony is that the term "pension asset" is not defined under Section 16-108.5 and therefore it is within the Commission's authority to define a pension asset under Section 16-108.5 of the Act as it deems appropriate. (Staff Ex. 13.0, p. 13) The Company's position as set forth by Ms. Houtsma appears to be that the Commission has no authority to define pension asset, which in this case under ComEd's definition is worth over **1 billion dollars**, because according to the Company it is defined under Section 16-108.5. According to Ms. Houtsma, it is simply the amount recorded on the Company's FERC Form 1. (ComEd Ex. 12.0, p. 11 "The wording of the statute is clear, concise, and straightforward: the legislature authorized an investment return on a pension asset as reported in the utility's FERC Form 1.")

The Company's argument must be rejected for a number of reasons. First, despite the Company's claim, Section 16-108.5 does not mandate that the Commission must use whatever amount appears on ComEd's FERC Form 1 as a pension asset. The only mandate is how the investment return on the pension asset is to be determined. Second, while the legislature chose in Section 16-108.5 to define the investment return on the pension asset as the "utility's long-term debt cost of capital as of the end of the applicable calendar year" it is telling that the legislature also chose to not provide a definition for the pension asset, leaving it up to the Commission to define a pension asset. Third, if ComEd's FERC Form 1 is all controlling, as ComEd suggests, and the amount listed on the FERC Form 1 must be taken by the Commission to be the pension asset, then ComEd does not live by that same rule when it seeks recovery of other amounts in its revenue requirement under Section 16-108.5. For example as discussed later on in this brief, the Company is seeking bank facility fees which are not included in the FERC Form 1. If ComEd's argument that the FERC Form 1 is all controlling, which it is not, then bank facility fees, which are not reported in FERC Form 1, would have to be removed from the rate of return on rate base. (Staff Ex. 18.0, pp. 3-4)

Finally, with regard to Section 16-108.5 while "[t]he language of the statute must be given its **plain** and **ordinary meaning …"** (People v. Pullen, 192 Ill. 2d 36, 42, (2000) (emphasis added)) as discussed above, pension asset is not defined and pension asset does not have a plain and ordinary meaning. The absence of a plain and ordinary meaning for the term pension asset is evidenced by the fact that ComEd and Staff each have proposed significantly different definitions for pension asset. In fact, ComEd's definition of a pension asset is actually identified in its financial statements as a "pre-paid pension asset"[8] not a pension asset. In addition, as will be discussed below, while the Commission has addressed the issue of a pension asset on several occasions in prior ComEd rate proceedings, the Commission: (1) has never defined it consistently; (2) has never defined it as ComEd suggests in this proceeding; and (3) has never found ComEd to even have a pension asset. Given the lack of a plain and ordinary meaning for the term pension asset and the absence of a definition provided in Section 16-108.5, the Commission has the authority to define pension asset as it deems appropriate.

[8] The amount which the Company seeks a return on is identified in ComEd's publicly available financial statements as a pre-paid pension asset in the amount of $1,039,000,000. (ComEd Ex. 12.2, p. 1) (emphasis added)

As previously mentioned, Staff's definition of a pension asset is different than what the Company proposes in this case and Staff readily admits that Staff's definition was not accepted by the Commission in a prior ComEd rate case, Docket No. 05-0597. However, given new facts not present when the Commission initially addressed the pension asset issue in Docket No. 05-0597, Staff respectfully requests that the Commission reconsider and adopt Staff's definition of pension asset for purposes of Section 16-108.5. Staff's recommendation as to how the Commission should define pension asset for purposes of Section 16-108.5 is as set forth below.

The Commission should disallow the pension funding costs included in the ComEd formula rate filing since, in Staff's opinion, no pension asset exists. According to Staff, a pension asset, fundamentally, is the amount by which ComEd's share of the pension plan is over funded. A review of the actuarial report of the relevant pension plans in which ComEd participates shows that ComEd's share of the plans are underfunded, not overfunded. ComEd participates in a pension plan sponsored by its parent company, Exelon Corporation ("Exelon"). The funded status of the overall Exelon plan as of December 31, 2010 was only 70.8%, and the funded status of plans applicable to ComEd was only 68.2% as of December 31, 2010. (Staff Ex. 1.0, Attachments A and B respectively) The pension is under-funded; no pension asset exists because ComEd's share of the pension obligation is greater than ComEd's share of the value of the pension plan assets. (Staff Ex. 1.0, Attachment C)

As discussed above, the Company claims that since it includes a line item described as "pension asset" in its financial reporting both in FERC Form 1 and its SEC 10K report, it meets the test for inclusion of pension funding costs under the formula rate methodology. As Ms. Ebrey correctly pointed out during redirect, quoting from ComEd cross-exhibit 6, "Nothing in this section is intended to allow costs that are not otherwise recoverable to be recoverable by virtue of inclusion in FERC Form 1." (*Tr.*, March 9, 2012, p. 461)

The Company also argues that the pension asset funding that ComEd proposes in the instant case is a "long-established practice" by the Commission. (ComEd Ex. 11, p. 9, lines 173-175; ComEd 12.0, p. 11, lines 250-253) Contrary to the Company's claim, the Commission does not have a "long-established practice" of allowing the recovery of the costs of pension assets in prior ComEd rate cases. The Commission has approved ratemaking adjustments based on <u>pension contributions</u> in ComEd rate cases since Docket No. 05-0597; however, the Commission has not accepted the Company's requests for recovery of a <u>pension asset</u> in those rate cases. The circumstances behind the ratemaking adjustments that were accepted by the Commission and the ultimate derivation of those adjustments varied for each rate case. Recovery was only allowed to the extent that there was ratepayer benefit resulting from the contribution. No evidence has been provided in this case to cause the Commission to reach a different conclusion in this case than it reached in the prior three ComEd rate cases about whether a pension asset exists (Docket Nos. 05-0597, 07-0566, and 10-0467).

While it is true that in Docket No. 05-0597, On Rehearing, the Commission stated in its analysis and conclusion that it was approving "cost recovery of the Pension Asset under Alternative 3 that ComEd proposed on rehearing." (Corrected Order on Rehearing, December 20, 2006, Docket No. 05-0597, p. 28) the Commission addressed the issue of the pension asset in Docket 05-0597 again in a subsequent docket. In an Amendatory Order for Docket No. 07-0566, the Commission stated the following with regard to its Order in Docket 05-0597:

> In accordance with our Order in Docket 05-0597, ComEd did not include the $803 million pension contribution in rate base and instead, included an annual debt return on the pension contribution of 4.75%. In this proceeding, ComEd did not re-litigate the merits of including the pension contribution in rate base.
> (Amendatory Order, November 3, 2008, Docket No. 07-0566, pp. 1-2)

The Commission in its amendatory order in Docket No. 07-0566, rather than define the $803 million as a pension asset as it did in the Order on Rehearing in Docket 05-0597, provided clarification that the recovery was not a return on a pension asset but rather a return on a pension contribution. There is a significant difference between a pension contribution and a pension asset, which Company witness Houtsma testified to during cross examination. (*Tr.*, March 13, 2012, p. 948).

The Company contradicts its argument that the Section 16-108.5(c)(4)(D) is consistent with the Commission's "long-established practice" for treatment of pension assets. In the Company's responses to Staff Data Requests TEE 12.01 and 12.02, the Company provided the calculations for pension funding costs using the data from this case and applying the Commission's conclusion from Docket No. 10-0467. That calculation does not use the amount recorded on ComEd's books as a pension asset at December 31, 2009 ($907,476,000) (ComEd Cross Ex. 11) but rather performs the calculation Ms. Ebrey described during her cross examination discussed above. (*Tr.*, March 9, 2012, p. 459 – 460) Staff and the Company are in agreement that the Commission's treatment of the pension funding issue in Docket No. 10-0467is **not** consistent with the requirements of Section16-108.5(c)(4)(D). (Staff Cross Exs. 10 and 11)

During redirect, Staff witness Ebrey, using the Company's own exhibit (Company Exhibit 12.1, Company Cross Ex. 11), explained exactly what the Commission allowed for recovery with regards to pension contributions (NOT pension assets recorded by the Company) in each of the last three rate cases. (*Tr.*, March 9, 2012, pp. 457 – 460) The Commission has never approved a return on what the Company has recorded as a **pension asset** on its books. Rather the recovery allowed has been based on the **discretionary pension contributions** and has been treated differently in each case where this issue has been considered. (Staff Ex. 13.0, pp. 6-10, lines 106-240)

The Company attempted to trivialize the difference between a pension contribution and a pension asset through the cross examination of Ms. Ebrey by ComEd's counsel, explaining that the pension contribution is "subsumed" in the pension asset. (*Tr.*, March 9, 2012, p. 426-427) However, during cross-examination, Company witness Houtsma readily agreed that a pension asset and a pension contribution are two entirely different things. (*Tr.*, March 13, 2012, p. 948)

Company witness Houtsma claims that Staff's adjustment is based on an "overly-narrow" definition of the term "pension asset". (ComEd Ex. 12.0, p. 5, lines 89-91) She further states that "the mere recording of the journal entries does not mean that rates should be impacted." (ComEd Ex. 21.0, p. 7, lines 149 – 152) Both of these criticisms describe Ms. Houtsma's position rather than Staff's position. The Company bases its argument solely on the mechanics of the accounting entries the Company has made on its books for the pension transactions between ComEd and Exelon. The ratemaking determination for the inclusion of a pension asset should be based on a much broader approach instead of Ms Houtsma's narrow view. Staff's approach views the overall status of the pension plan and all its components as it relates to the utility on a stand-alone basis, including: 1) the current fair value of the assets in ComEd's share of the pension trust (rather then the amount of contributions made in the year); 2) ComEd's share of the pension benefit obligation (rather than the amount of expense to be recognized in the year); and 3) the overall funded status of ComEd's share of the plan (rather than the prepayment of pension costs for the year). (Staff Ex. 13.0, p. 12, lines 278 – 289)

Company witness Graf and, to a limited extent, Ms. Houtsma, discuss the proper accounting for the Exelon pension plans by both Exelon and ComEd. Staff does not take issue with the accounting entries recorded by the companies but rather bases its position in part on the substance of the pension plan and the plan's funded status as a stand alone entity, consistent with the treatment of other ratemaking issues. For example, while affiliated companies often file consolidated income tax returns, the income tax included for ratemaking purposes is computed on a stand-alone basis. In addition, Section 9-230 of the Act specifically addresses this issue as it relates to rate of return for rate cases.

> Rate of return; financial involvement with nonutility or unregulated companies. In determining a reasonable rate of return upon investment for any public utility in any proceeding to establish rates or charges, the Commission shall not include any (i) incremental risk, (ii) increased cost of capital, or (iii) after May 31, 2003, revenue or expense attributed to telephone directory operations, **which is the direct or indirect result of the public utility's affiliation with unregulated or nonutility companies.**
> (220 ILCS 5/9-230, emphasis added)

Accordingly, the Commission should also view the pension asset in the same way on a stand alone basis.

Finally, as mentioned above, Staff recognizes that the Commission did not accept Staff's definition of pension asset in Docket No. 05-0597. However, more is known today about ComEd's and Exelon's intentions to fund the pension plan in the future then was known in 2005. In Docket No. 05-0597, the Company argued to the Commission that not recognizing a pension asset creates a disincentive for utilities to fund pensions. (Corrected Order on Rehearing, December 20, 2006, Docket No. 05-0597, p. 19) ComEd also argued that the contribution to the pension plan which created the pension asset was part of a larger effort by Exelon to fund its pension plan for all employees. (Order, July 26, 2006, Docket No. 05-0597, p. 29) The evidence in this record shows that the incentive is not working (ComEd's share of the pension plan is only 68.2% funded as of December 31, 2010 (Staff Ex. 1.0, Attachments A and B respectively) and that in the future the Company is focused on making minimum pension payments. If ComEd was committed to funding its pension plan above and beyond what is required by law, which ComEd's arguments may have led the Commission to believe the Company was going to do back in 2005, then one would expect ComEd to have eventually obligated itself to have the pension plan fully funded within a certain number of years. However, no such commitment has been made by ComEd or Exelon in their 2010 financial statements. (*Tr.*, March 13, 2012, p. 893) In fact, of the factors that management considers significant enough to set forth in ComEd's financial statements regarding the funding of the pension plan, ComEd management focuses on the minimum not the maximums ("management considers various factors when making pension funding decisions, including actuarially determined minimum contribution requirements under ERISA, contributions required to avoid benefit restrictions and at-risk status as defined by the Pension Protection Act of 2006, …") (*Tr.*, March 13, 2012, p. 923; Staff Cross Ex. 8, (Annual Report p. 117) Even ComEd in its collective bargaining agreement with the IBEW Local 15 is not required to fully fund the pension plan by a certain date. (*Tr.*, March 12, 2012, p. 663) Finally, counsel for ComEd even stated on the record that "[w]ell there's no commitment that ComEd would fully fund its Pension Plan." (*Tr.*, March 12, 2012, p. 665) Because ComEd has not obligated itself to make pension plan contributions above the minimum required by law, the incentive the Commission allowed the Company back in Docket No. 05-0597 no longer is appropriate. In addition, Staff would further point out that the other large utility in northern Illinois, Nicor Gas, has been able to achieve a fully funded pension plan without the Commission-provided incentive of allowing a return on a 'pension asset.' (Order, September 20, 2005, Docket No. 04-0779, p. 23; Order, March 25, 2009, Docket No. 08-0363, p. 18) Given all of the above, Staff recommends that the Commission adopt Staff's definition of pension asset set forth by Staff witness Ebrey in her testimony.

Based on the foregoing discussion, the Commission should approve Staff's adjustment to disallow a return on a pension asset as provided for under Section 16-108.5(c)(4)(D).

b. Pension Expense

If the Commission determines it is appropriate to allow any type of recovery related to excess pension contributions through the end of 2010 in the rates approved in this proceeding (by rejecting Staff's proposal as discussed above), the approved pension expense should likewise be reduced by $9.977 million to reflect the impact of those excess contributions as presented in Staff's direct testimony. (Staff Ex. 1.0, pp. 12-13, lines 218 – 246)

Since the amount of pension expense recorded by ComEd in 2010 was based on a March 2010 actuarial study, it did not reflect the impact of the special discretionary contributions made by the Company in the latter half of 2010. Those contributions make up a portion of the "pension asset" the Company proposes to use in its pension asset funding calculation. If the Commission allows recovery of pension asset funding in some manner that includes those later contributions, the Company will benefit through a higher revenue requirement. In order to balance the interests of the ratepayers with that of the utility, the impact of those later contributions should be reflected in a reduced pension expense in the revenue requirement as well. This same treatment was directed by the Commission in its Order on Rehearing in Docket No. 05-0597:

> In addition, and as a matter of internal consistency, because the annualized interest expense will be included in the Company's revenue requirement, then the annual effect of the contribution on the return component of the periodic pension expense should also be included in the Company's revenue requirement.
> (Order on Rehearing, December 20, 2006, Docket No. 05-0597, p. 28.)

The Company argues that pension expense must be supported by an actuarial study by statute. (ComEd Ex. 12.0, p. 13, lines 294 – 296) Staff does not disagree with that requirement and believes Staff's proposal does comply with the statutory language. Staff's adjustment is based on the **2010 actuarial study** adjusted for the impact of the excess pension contributions made in 2010. If the Commission does not agree that Staff's adjustment to the 2010 actuarial study amount of pension expense is consistent with the statute, then the most current actuarial study (i.e., 2012) which does reflect the impact of the 2010 excess pension contributions should be used as the basis for pension expense in the revenue requirement. Using the 2012 actuarial study would mitigate any over or under recovery of pension expense that would result when the reconciliation of the 2012 FERC Form 1 data is performed beginning in May 2013. (Staff Ex. 13.0, p. 16, lines 367 - 376)

If the Commission does accept Staff's proposal disallowing any amount for pension asset funding, then no adjustment to pension expense as proposed by the Company would be necessary.

6. Income Taxes: Interest Synchronization

7. Other

VI. RATE OF RETURN

A. Overview, Including Overall Cost of Capital

Staff witness Rochelle Phipps presented her recommendation for a fair rate of return on rate base for ComEd's electric delivery services, pursuant to the provisions of Section 16-108.5 of the Act. Ms. Phipps recommends the following rate of return on rate base, including an average 2010 capital structure, for setting formula rates:

Staff's Proposed Average 2010 Rate of Return on Rate Base Summary

Capital Component	Balance (In Thousands)	Weight	Cost	Weighted Cost
Short-Term Debt	$48,373	0.53%	0.72%	0.00%
Long-Term Debt	4,880,640	53.35%	6.42%	3.43%
Common Equity	4,219,095	46.12%	10.05%	4.64%
Bank Facility Fees				0.10%
Total	$9,148,108	100.00%		8.16%
Source: Staff Ex. 7.0, p. 2 and Sch. 7.01				

Staff and the Company agree on the short-term debt balance, the cost of short-term debt, the cost of equity and including an adder for the cost of bank facilities. (Staff Ex. 7.0, Sch. 7.01; ComEd Prehearing Memo, p. 50; ComEd Ex. 13.2)

The remaining contested issues relate to Staff's recommendations to: (1) calculate average balances of long-term debt and common equity; (2) remove remaining construction work in progress accruing an allowance for funds used during construction from long-term debt and equity balances; and (3) remove effects of non-utility and unregulated affiliates from the Company's equity balance and bank facility fees, as required by Section 9-230 of the Act. (Staff Prehearing Memo, pp. 13-14) Staff describes each of these contested issues hereafter.

B. Capital Structure

1. Year End/Average Year Capital Structure

Ms. Phipps calculated average balances of short-term debt, long-term debt and common equity in accordance with 83 IL Adm. Code 285.4000. (Staff Ex. 7.0, pp. 2, 3 and 5) Specifically, Staff recommends calculating the capital structure as follows. First, calculate the average short-term debt balance, including the amount of remaining construction work in progress that is accruing an allowance for funds used during construction, and the cost to maintain credit facilities using "Sch FR D-1 WP 12," which would be substantially similar to ICC Staff Schedule 7.02. Second, Staff recommends calculating the average balance and embedded cost of long-term debt using "Sch FR D-1 WP 14," which would be substantially similar to ICC Staff Schedule 18.02, pp. 1-6. Staff's proposed "Sch FR D-1 WP 14" also includes the embedded cost of long-term debt for the end of the applicable year, which is the statutorily required return on any "net pension asset" authorized by the Commission pursuant to Section 16-108.5(c)(4)(D) of the Act, which states:

> Permit and set forth protocols, subject to a determination of prudence and reasonableness consistent with Commission practice and law,

> for…investment return on pension assets net of deferred tax benefits ***equal to the utility's long-term debt cost of capital as of the end of the applicable calendar year***.
> (220 ILCS 5/16-108.5(c)(4)(D))

Finally, Staff recommends calculating the average common equity balance, including adjustments to remove non-utility and unregulated affiliates, using "Sch FR D-1 WP 15," which would be substantially similar to ICC Staff Schedule 7.05.

Ms. Phipps recommends an average capital structure for setting formula rates for two reasons. First, an average capital structure more accurately measures a company's earned rate of return on common equity for a calendar year, which is required for the purpose of determining customer surcharges or refunds under Section 16-108.5(c)(5). Second, average capital structures are less sensitive to manipulation than end of year measurement dates. For example, delaying a common dividend payment from the end of a year until the beginning of the next year could significantly increase a utility's end of year common equity ratio, which would reduce its earned rate of return for the purpose of reconciliation as set forth in Section 16-108.5(d) of the Act. (Staff Ex. 7.0, p. 2)

a. Average Capital Structures Comprising Actual Balances are Actual Capital Structures

As will be discussed below, in essence, the Company's position is that an actual capital structure must comprise end-of-year balances - unless ComEd decides otherwise, and that all components of an actual capital structure must come from the FERC Form 1 - unless ComEd determines otherwise. Of course, the Commission's objective should be to measure capital structure as accurately as possible since capital structure is a crucial component both for setting rates and for the measurement of earned rate of return on common equity.

The Company alleges that an average capital structure does not qualify as actual capital structure because it does not rely exclusively on data provided in the FERC Form 1. (Staff Ex. 18.0, p. 2, citing Company response to ICC Staff DR RMP 11.01) Of course, the Company suspends its rule when it comes to the balance of long-term debt, short-term debt, construction work-in-progress accruing an allowance for funds used during construction, and bank facility fees. Rather, the Company admits that it has "taken [its proposed equity and debt balances] from a series of other numbers which all may be actual numbers but does not rely on the final data reflected in the FERC Form 1." (Staff Ex. 18.0, pp. 2-4) Specifically, the source for ComEd's long-term debt data, as presented in App 13 and WP 13, is ILCC Form 21 instead of FERC Form 1. Similarly, App 12 and WP 12 provide thirteen month-end balances of short-term debt data even though FERC Form 1 and ILCC Form 21 annual reports only disclose the December 31 balances of short-term debt and construction work in progress (but not construction work in progress accruing an allowance for funds used during construction). Finally, bank facility fees (also provided on WP 12, page 2) are not included in either FERC Form 1 or ILCC Form 21 but instead are included in invoices from lenders and credit facility arrangers and other supporting documentation.

Therefore, if ComEd's argument was valid, which it is not, then bank facility fees, which are not reported in FERC Form 1, would have to be removed from the rate of return on rate base. (Staff Ex. 18.0, pp. 3-4) In contrast, Ms. Phipps explained that average capital structures are acceptable under the Commission's past practices and rules. (Staff Ex. 18.0, p. 2, citing 83 Ill. Adm. Code 285.4000(b))

b. Average Capital Structures More Accurately Measure the Earned Rate of Return on Equity for a Calendar Year than Year-End Capital Structures

Ms. Phipps testified that an average capital structure would more accurately measure ComEd's earned return on equity than capital structures measured on a single date for reconciliation purposes. She noted that ComEd proposes to calculate the rate of return on common equity for reconciliations as DS ROE = DS Net Income / DS Equity Balance. (Sch FR A-3, line 26) The numerator, "DS Net Income," represents earnings during the calendar year. In contrast, the Company proposal would measure the denominator, "DS Equity Balance," at a single point in time – the last day of the calendar year. As such, the denominator would mis-state the amount of common equity that ComEd had invested during the twelve months over which ComEd generated the net income reflected in the numerator. (Staff Ex. 18.0, pp. 4-5)

Dr. William E. Avera, testifying for the Company before the FERC, stated that return on end of year common equity is less accurate than return on average equity:

> In *Southern California Edison*, the Commission [FERC] correctly recognized that if the rate of return, or "r" component of the br+sv growth rate, is based on end-of-year book values, such as those reported by Value Line, it will understate actual returns because of growth in common equity over the year. [citation omitted] Accordingly, consistent with the Commission's findings and the theory underlying this approach to estimating investors' growth expectations, an adjustment was incorporated to compute an average rate of return.
>
> (FERC Docket No. ER07-583-000, Appendix D William E. Avera – Direct Testimony and Exhibits)[9]

Further, Standard & Poor's uses average common equity in its calculation of return on common equity, which methodology finance textbooks support. (Staff Ex. 18.0, p. 5)

c. Average Capital Structures are Less Sensitive to Manipulation than Year-End Capital Structures

[9] This testimony also notes, "Use of average return in developing the sustainable growth rate is well supported. See, *e.g.*, Morin, Roger A., "Regulatory Finance: Utilities' Cost of Capital," Public Utilities Reports, Inc. (1994), which discusses the need to adjust Value Line's end-of-year data, consistent with the Commission's findings in *Southern California Edison*."

Staff's proposal to use average capital structures for formula rates would not make it impossible to manipulate capital structure for ratemaking purposes; however, since the average comprises thirteen observations, any single month end balance has less influence on the average. In other words, the manipulation of capital structure through the timing of capital issuances and retirements would have a smaller effect on a capital structure comprising average balances than a capital structure comprising single, end of year balances. (Staff Ex. 18.0, p. 6)

Ms. Phipps refuted ComEd's claim that "all of the drivers of ComEd's capital structure involve complex transactions that would be difficult, if not impossible, to manipulate" by illustrating how transactions as ordinary as issuing $100 million long-term debt to replace short-term debt (or, conversely, using $100 million short-term debt to bridge long-term financing) can affect a year-end capital structure. (Staff Ex. 18.0, p. 7)

Capital Structure: End of Year per ComEd versus Average per Staff

	ComEd Methodology		**Staff Methodology**	
	Average balance of short-term debt and end-of-year balances for long-term debt and common equity		Average balances for short-term debt, long-term debt and common equity	
	Amount (in millions)	Ratio	Amount (in millions)	Ratio
Scenario 1:				
Constant balances every month:				
Short-Term Debt	$100	5.0%	$100	5.0%
Long-Term Debt	$900	45.0%	$900	45.0%
Common Equity	$1,000	50.0%	$1,000	50.0%
Total Capital	$2,000	100.0%	$2,000	100.0%
Scenario 2:				
Replace $100 million short-term debt with $100 million long-term debt in December 2010:				
Short-Term Debt	$96	4.6%	$96	4.8%
Long-Term Debt	$1,000	47.7%	$904	45.2%
Common Equity	$1,000	47.7%	$1,000	50.0%
Total Capital	$2,096	100.0%	$2,000	100.0%
Scenario 3:				
Replace $100 million long-term debt with $100 million short-term debt in December 2010:				
Short-Term Debt	$104	5.5%	$104	5.2%
Long-Term Debt	$800	42.0%	$896	44.8%
Common Equity	$1,000	52.5%	$1,000	50.0%
Total Capital	$1,904	100.0%	$2,000	100.0%
Note: Tables supporting these calculations are provided in ICC Staff Ex. 18.0, pp. 7-11.				

Ms. Phipps first showed that the year-end capital structure is identical to the average capital structure when the month-end balances for each capital component remain constant every month for a given calendar year, as summarized under Scenario 1. (*See* Staff Ex. 18.0, pp. 7-8)

The summary for Scenario 2 reflects the effect of refinancing $100 million of short-term debt with $100 million long-term debt on December 31st. Although replacing short-term debt for the same amount of long-term debt does not change total debt, ComEd's method for measuring capital structure would incorrectly indicate that total debt had risen. Specifically, the total debt ratio in the end of year capital structure increases to 52.3%[10] from 50% and total capital for the end of year capital structure increases to $2,096 million from $2,000 million. In contrast, using Staff's methodology, the total debt ratio for the average capital structure correctly remains at 50% and total capital remains at $2,000 million. (Staff Ex. 18.0, pp. 8-10)

Conversely, the reverse refinancing transaction – *i.e.*, refinance $100 million of long-term debt with $100 million of short-term debt during December 2010 – also affects the end of year capital structure more than the average capital structure, as summarized under Scenario 3. Specifically, using ComEd's methodology, the end of year capital structure would misleadingly indicate that the total debt ratio had fallen to 47.5%[11] from 50% and total capital for the end of year capital structure had fallen to $1,904 million from $2,000 million. In contrast, using Staff's methodology, the total debt ratio for the average capital structure correctly remains at 50% and the total capital remains at $2,000 million. (Staff Ex. 18.0, pp. 10-11)

Ms. Phipps asserts that the Company's claim that the drivers of ComEd's capital structure are subject to several levels of internal review, including review and approval by the Company's Board of Directors, should not give the Commission confidence that ComEd's end of year capital structure is not subject to manipulation. Rather, this should provide little comfort to the Commission (and customers) given the Board of Directors are elected by and answer to shareholders, not customers. Further, the earnings collar in Section 16-108.5(c)(5) of the Act gives ComEd the incentive to under-report earned rate of return on common equity since ComEd must refund 100% of earnings above the earnings collar. (Staff Ex. 18.0, p. 6)

The Company incorrectly claims, "Commission review would be effective to prevent any speculative attempt at manipulation," negating the need to use average capital structures in formula rates (ComEd Ex. 15.0, lines 71-73). However, Ms. Phipps explained that assessing the prudence or reasonableness of the <u>timing</u> of debt and equity financing is problematic. Outside parties would be hard-pressed to refute a utility assertion that the utility changed the date of a debt issuance a few weeks or months because of capital market conditions. (Staff Ex. 18.0, p. 6) In contrast, averaging monthly balances mitigates the effect of manipulation of the timing of financing

[10] 52.3% = ($96 million short-term debt + $1,000 million long-term debt) ÷ $2,096 million total capital.

[11] 47.5% = ($104 million short-term debt + $800 million long-term debt) ÷ $1,904 million total capital.

decisions on the capital structure and consequently reduces the incentive to manipulate the timing of financing decisions.

2. Long-term Debt and Equity Adjustment Regarding CWIP Accruing AFUDC

a. Staff's CWIP Adjustment is Consistent with Commission Rules and Commission Practices

Ms. Phipps removed the portion of long-term debt that is reflected in the Allowance for Funds used During Construction ("AFUDC") rate because the Commission's formula for calculating AFUDC assumes short-term debt is the first source of funds financing construction work in progress ("CWIP"); however, it is not necessarily the only source. That formula also assumes that any CWIP not funded by short-term debt is funded proportionately by the remaining sources of capital (*i.e.*, long-term debt and common equity). Thus, to avoid double counting the portions of long-term debt and common equity that the AFUDC formula assumes is financing CWIP, Ms. Phipps subtracted $31,992,000 from the long-term debt balance and $27,656,000 from the common equity balance. (Staff Ex. 7.0, p. 4)

Ms. Phipps explained further that the Company had a higher balance of CWIP than short-term debt for nine months of December 2009 through December 2010. Therefore, the AFUDC formula assumes that a portion of CWIP is funded with the long-term sources of capital during those months. After removing the portion of short-term debt that is reflected in the AFUDC calculation, any remaining amount of CWIP accruing AFUDC was allocated to long-term debt and common equity based on their proportions to total <u>long-term</u> capital. The average monthly balance of CWIP accruing AFUDC that the AFUDC formula assigns to long-term capital is $59,648,000. Long-term debt composes 53.63% of long-term capital. Thus, $31,992,000 of long-term debt financing CWIP (*i.e.*, 53.63% × $59,648,000) is subtracted from the carrying value of outstanding long-term debt and, similarly, common equity composes 46.37% of long-term capital; therefore, the AFUDC formula assumes that 46.37% of $59,648,000, or $27,656,000, of common equity is financing CWIP accruing AFUDC. (Staff Ex. 7.0, pp. 4-5) Staff recommends calculating adjustments to the long-term capital components that result from remaining CWIP accruing AFUDC using "Sch FR D-1 WP 13," which would be substantially similar to ICC Staff Schedule 7.03.

Staff made the same adjustment in Docket No. 10-0467. In that case, Company witness Mr. Martin Fruehe testified that he did not argue with the adjustment and agreed with the methodology. (Staff Ex. 18.0, p. 20)

b. Staff's Remaining CWIP Adjustment is based on the Commission's AFUDC Formula and Effectively Avoids Double Counting Dollars Assumed to Finance CWIP and Dollars Assumed to Finance Rate Base Assets

ComEd opposes Staff's CWIP adjustment, arguing that the construction work in progress adjustment uses "direct assignment in determining capital structure." (ComEd

Ex. 15.0, lines 115-116) Ms. Phipps explained that the construction work in progress adjustment does assign capital to specific uses, although that is not possible in practice. Nevertheless, Staff's adjustment is necessary because the Commission's allowance for funds used during construction formula, which the Company relies on to reduce its balance of short-term debt for rate setting purposes, assigns a specific combination of short-term debt and long-term capital to construction work in progress despite the fungible nature of capital. In other words, the Company accepts the allowance for funds used during construction formula-based assignment of capital for the purpose of its adjustment to the balance of short-term debt but inconsistently rejects that same basis for adjusting the balances of long-term debt and common equity. (Staff Ex. 18.0, p. 17)

Ms. Phipps illustrated the problem associated with accepting CWIP-related adjustments to the short-term debt calculation but rejecting the CWIP-related adjustments to long-term debt and common equity in Staff Ex. 18.0, Schedule 18.01. Specifically, Staff showed that adjusting only short-term debt causes the sum of total capital financing CWIP and rate base assets to exceed the total capital on the balance sheet. (*See* the First Scenario in Staff Schedule 18.01.) In contrast, Staff's adjustments to long-term debt and equity, as illustrated in the Second Scenario in Staff Ex. 18.0, Schedule 18.01, avoid double counting capital used to calculate rate of return on rate base. That is, in the First Scenario, the sum of total capital financing CWIP and rate base assets exceeded the amount of capital on the balance sheet, whereas in the Second Scenario, the sum of total capital financing CWIP and rate base assets equaled the amount of capital on the balance sheet. (Staff Ex. 18.0, pp. 14-16 and Schedule 18.01)

Similarly, if the capital structure reflected a gross short-term debt balance[12] instead of a net short-term debt balance (which removes short-term debt assigned to calculating the allowance for funds used during construction[13]), then it would be unnecessary to adjust long-term capital components. No double counting of capital occurs when the allowance for funds used during construction-related adjustments to short-term debt and long-term capital are either both accepted or rejected. However, accepting only one of those adjustments (*e.g.*, combining a net short-term debt balance with unadjusted long-term debt and equity balances) would result in a mismatched capital structure measurement that would only benefit the Company. (Staff Ex. 18.0, pp. 14-17 and Sch. 18.01)

The Company argues that double counting is impossible given construction work in progress that accrues an allowance for funds used during construction is not in rate base and the debt and equity supporting the construction work in progress that accrues an allowance for funds used during construction is only included in the capital structure once. (ComEd Ex. 15.0, lines 122-125) This is incorrect. First, although construction work in progress is not in rate base, its balance does include financing costs (*i.e.*, the accrual of an allowance for funds used during construction). When construction is completed, construction work in progress is reclassified as plant in service, the cost of which is recovered from customers through depreciation. Consequently, the revenue

[12] *See* Staff Ex. 7.0. Schedule 7.02, Page 1 of 2, Column (B).
[13] *See* Staff Ex. 7.0. Schedule 7.02, Page 1 of 2, Column (E).

requirement includes both the rate of return on rate base and the financing costs that accrued during plant construction. (Staff Ex. 18.0, p. 18)

Second, the Commission rule for calculating AFUDC has effectively resulted in two capital structures: one for determining the allowance for funds used during construction, the other for determining the rate of return on rate base. If the sum of the debt and equity components used to develop these capital structures exceeds the balances of debt and equity on the utility's financial statements (after adjustment for disallowances), double counting has occurred. (Staff Ex. 18.0, p. 18)

c. The Company's Proposal to Remove "Net Pension Assets" from the Long-Term Debt Balance is Baseless and Should be Rejected

The Company argues that if the Commission agrees with removing remaining construction work in progress from the long-term capital balances, then it should remove an amount of long-term debt equal to the "net pension asset" because the pension asset funding cost is derived from the cost of debt. (ComEd Ex. 15.0, lines 131-137) However, removing approximately $542 million of "net pension asset" from the long-term debt balance would cause the ratio of common equity to increase relative to the ratio absent such adjustment. This shifting of weights between lower cost debt and higher cost of equity would cause the cost of capital, and ultimately the revenue requirement, to increase. Specifically, assuming, for the sake of illustration only, that the "net pension asset" equals the Company's position of $542,360,000, the Company's proposed adjustment to the balance of long-term debt would effectively result in a "net pension asset" revenue requirement that is approximately $20 million higher than the amount that would be otherwise specified in Section 16.108.5(c)(4)(D) of the Act.[14] (Staff Ex. 18.0, pp. 19-20 and Attachment A)

3. Equity Adjustment Regarding ComEd of Indiana

Section 9-230 of the Act provides that:

> In determining a reasonable rate of return upon investment for any public utility in any proceeding to establish rates or charges, the Commission shall not include any (i) incremental risk, (ii) increased cost of capital, or (iii) after May 31, 2003, revenue or expense attributed to telephone directory operations, which is the direct or indirect result of the public utility's affiliation with unregulated or nonutility companies.
> (220 ILCS 5/9-230)

As required by Section 9-230 of the Act, Ms. Phipps subtracted the balance of common equity invested in Commonwealth Edison Company of Indiana, Inc. from ComEd's common equity balance because ComEd of Indiana is not an Illinois utility as defined in

[14] By using this illustration, Staff is not endorsing the Company's position on the "net pension asset" issue.

Section 3-105 of the Act. (Order, Docket No. 03-0449, September 22, 2003, pp. 1-2) Therefore, ComEd of Indiana is both an unregulated and a non-utility affiliate of ComEd. (Staff Ex. 18.0, p. 20)

Ms. Phipps explained that the Company's investment in ComEd of Indiana results in a higher equity balance for ComEd since ComEd of Indiana's capital structure is wholly comprised of common equity. (Staff Ex. 18.0, p. 21; ComEd Ex. 23.1, p. 2)

The Company argues that ComEd of Indiana does not increase ComEd's cost of capital because it does not add to the equity percentage in ComEd's capital structure. (ComEd Ex. 15.0, lines 165-167) In response, Ms. Phipps explained that the Commission is establishing a methodology for calculating ComEd's equity balance in this case and there is no guarantee that ComEd's investment in the Indiana subsidiary will not have a greater effect in future formula rate proceedings. (Staff Ex. 18.0, p 21) Therefore, the Commission should adopt Staff's methodology for adjusting ComEd's common equity balance in a manner consistent with Section 9-230 of the Act.

4. Common Equity Ratio/Cap Limit

5. Subsequent Procedure/Process Re: Capital Structure Issues

Staff witness Ms. Kight-Garlisch explained that the capital structure affects the overall cost of capital. Increasing the proportion of common equity in a utility's capital structure reduces financial risk, thereby lowering the cost of each source of capital. However, common equity is the most costly source of capital. Therefore, an excessive proportion of common equity unnecessarily raises the overall cost of capital. Nevertheless, a capital structure with an inadequate proportion of common equity also unnecessarily raises the cost of capital since reducing the proportion of common equity in a utility's capital structure increases financial risk, thereby raising the cost of each source of capital. In other words, above a certain common equity ratio, increasing the proportion of common equity increases the overall cost of capital despite reducing the individual component costs. Below a certain common equity ratio, decreasing the proportion of common equity has a smaller effect on the overall cost of capital than the increase in the costs of debt and common equity. In contrast, the authorized rate of return on common equity under Section 16-108.5 of the Act is only a function of two factors: (1) the average yield on 30-year U.S. Treasury bond yields plus 580 basis points; and (2) possible performance penalties. That is, Section 16-108.5 severs the link between the rate of return on common equity and capital structure. Consequently, the authorized rate of return on common equity would not decrease in response to an increase in the common equity ratio. Therefore, absent rigorous Commission oversight of capital structure, Section 16-108.5 would provide ComEd an incentive to increase its common equity ratio. (Staff Ex. 12.0, p. 2)

Since ComEd's 2010 capital structure evolved prior to the reductions in operating risk resulting from the passage of Public Acts 97-0616 and 97-0646 (" Illinois' formula rate law"), Staff witness Kight-Garlisch did not recommend that the Commission adopt an alternative capital structure for 2012. Nonetheless, it is possible that a capital structure containing a 46% common equity ratio would not be prudent and reasonable on a going-forward basis. The magnitude of the positive effect of Section 16-108.5 of the Act on the Company's risks is unknown at this time. However, the rating agencies have clearly stated that the Illinois' formula rate law will have a positive effect on companies. (Staff Ex. 23.0, pp. 1-2) In fact, Moody's upgraded ComEd's credit ratings one notch primarily due to the passage of Illinois' formula rate law. (Staff Cross Ex. 2) Consequently, Ms. Kight-Garlisch recommends that the Commission order the Company to work with Staff to explore more leveraged capital structures for future years and provide a report to the Commission with its 2013 formula rate filing. (Staff Ex. 12.0, p. 2)

6. Other

C. Cost of Capital Components

1. Cost of Short-Term Debt

The Company agrees with Staff's recommended .072% cost of short-term debt, which is based on the weighted average cost of short-term debt, as presented in ComEd's 2010 Form 10-K. (Staff Ex. 7.0, p. 6; ComEd Ex. 15.0, p. 9)

2. Cost of Credit Facilities

ComEd was Assigned an Amount of Bank Facility Fees that Violates Section 9-230 of the Act

As mentioned above Section 9-230 of the Act provides that:

> In determining a reasonable rate of return upon investment for any public utility in any proceeding to establish rates or charges, the Commission shall not include any (i) incremental risk, (ii) increased cost of capital, or (iii) after May 31, 2003, revenue or expense attributed to telephone directory operations, which is the direct or indirect result of the public utility's affiliation with unregulated or nonutility companies.
> (220 ILCS 5/9-230)

In accordance with Section 9-230 of the Act, Ms. Phipps adjusted the arrangers' fees for the community and minority owned bank credit facilities to 34%, which equals ComEd's pro rata share of costs associated with credit facilities for ComEd and its non-utility affiliates. Specifically, ComEd's $32.15 million one-year credit facility comprises 34% of aggregate community and minority-owned bank credit facilities between ComEd and its non-utility affiliates, which total $94.3 million. (Staff Ex. 7.0, p. 7)

The Company opposes this adjustment and argues:

> Ms. Phipps incorrectly presumes that ComEd is a participant in an Exelon-wide community and minority-owned bank credit facility. ComEd, PECO and Exelon Generation each have separate community and minority-owned bank credit facilities. While there is some overlap in the arranging

> and administering banks, only ComEd can draw on its facility, and ComEd gets no benefit from the PECO and Exelon Generation facilities.
> (ComEd Ex. 15.0, lines 200-205)

Ms. Phipps explained that in October 2010, Exelon Corporation ("Exelon") established three community and minority-owned bank credit facilities – the $32.15 million ComEd facility, the $32.15 million PECO Energy Company ("PECO") facility and the $30 million Exelon Generation Company, LLC ("ExGen") facility. Ms. Phipps took issue with the arrangement fees for JP Morgan and Seaway Bank and Trust that were assigned to ComEd. Ms. Phipps reduced those arrangement fees that were assigned to ComEd to 34% of total arrangement fees, based on the proportion of ComEd's $32.15 million credit facility relative to the three facilities combined (totaling $94.3 million). (Staff Ex. 18.0, pp. 22-23) Those adjustments are based on Section 9-230 of the Act, which prohibits including in a utility's allowed rate of return any increased cost of capital which is the direct or indirect result of the public utility's affiliation with unregulated or non-utility companies.

There is no evidence that ComEd separately negotiated arranger fees from JPMorgan or Seaway for the ComEd facility. First, the three credit facilities were entered into during October 2010 and the arrangers' fee letters reference the other two facilities. Second, the JPMorgan fee summary refers to "Total per fee segment" and sums the total fees due by ComEd, PECO and ExGen. Finally, both JPMorgan and Seaway charged the same upfront, arrangement and agency fees for ComEd's $32.15 million facility as PECO's $32.15 million facility, and the fees associated with ExGen's $30 million facility are proportionately smaller, which is consistent with allocating those fees rather than separately negotiating fees for the ComEd facility. (Staff Ex. 18.0, pp. 23-24) ComEd has failed to explain why ComEd and its regulated affiliate PECO were charged disproportionately higher upfront fees than their unregulated affiliate, ExGen.

The Company argues that "[i]n the absence of a finding that the fees were unreasonable or imprudent...they should be fully recoverable on a jurisdictional basis in ComEd's rates." (ComEd Ex. 15.0, lines 206-208) The Company asserts that the Commission determined that the fees associated with the community and minority-owned bank credit facility were prudent and reasonable in three proceedings: Docket Nos. 10-0467, 10-0539 and 11-0618. However, Staff's adjustment is not based on whether the fees associated with ComEd's small bank credit facility are unreasonable or imprudent. Rather, this adjustment is necessary because the <u>allocation</u> of the bank fees incurred under the Exelon small bank credit facilities is inconsistent with Section 9-230 of the Act. (Staff Ex. 18.0, p. 24)

Contrary to the Company's claim, the Commission did not "review and approve" the costs of ComEd's 2010 community and minority-owned bank facilities in Docket No. 10-0467 (ComEd's previous rate proceeding). Ms. Phipps testifies that there is no mention of the small bank credit facility in either Schedule D-2 or the Company testimony in Docket No. 10-0467. The only bank facility costs included in the credit facility costs in Docket No. 10-0467 were associated with the Company's $1 billion credit facility. With regard to Docket No. 10-0539, Staff witness Ms. Sheena Kight-Garlisch testifies that she did not evaluate whether the fees assigned to ComEd were consistent with Section 9-230 of the Act when she reviewed the Company's petition.

(ICC Staff Ex. 23.0, pp. 3-4) Lastly, Docket No. 11-0618 does not concern the community and minority-owned bank credit facility whose fees ComEd is seeking to recover in this proceeding but the successor credit facility. Therefore, the Commission could not have found the assignment of those costs consistent with Section 9-230 of the Act. (Staff Ex. 18.0, pp. 24-25)

In Docket Nos. 09-0306 through 09-0311 and Docket No. 11-0279, the Commission accepted a very similar adjustment to Ameren Illinois Company's credit facility costs on the basis of Section 9-230 of the Act. (Order, Docket Nos. 09-0306 et al., April 29, 2010, pp. 157-158; Order, Docket No. 11-0282, January 10, 2012, p. 63)

Ms. Phipps made two other adjustments to the bank facility fees. She removed fees associated with borrowings outside of calendar year 2010 and ComEd's collateral postings to PJM, which the Company recovers through Rider PE. Notably, the Company's calculation of annual amortization of upfront fees for the credit facilities includes costs associated with prior credit facilities that ComEd replaced in 2010 with its current credit facilities. Ms. Phipps did not investigate whether those costs are prudent for the formula ratemaking proceeding because any adjustment to remove those costs would have a negligible effect on ComEd's cost of capital. As such, Ms. Phipps' acceptance of the inclusion of costs associated with the prior credit facilities should not be construed that she concluded that those costs were prudently incurred. (Staff Ex. 17.0, pp. 6-7)

3. Cost of Long-Term Debt

Staff and the Company do not agree on the cost of long-term debt. As explained previously in Section VI.B.1 and VI.B.2. of this brief, Staff recommends an average embedded cost of long-term debt and an adjustment to remove remaining construction work in progress from the long-term debt balance, both of which the Company opposes. Staff recommends the Commission adopt Staff's position on the basis it is consistent with the Commission's own rules and past practices. (Staff Ex. 18.0, pp. 2-20)

4. Cost of Common Equity

Staff and the Company agree that the cost of equity, which methodology is established by statute, equals 10.05%.

VII. COST OF SERVICE AND RATE DESIGN

The Company's filing falls short in two ways with respect to cost of service and rate design. First, the Company has failed to specify how it plans to address the Commission cost of service directives from the Order in Docket No. 08-0532 that have yet to be addressed. Second, with respect to rate design, the Company's proposed fixed and variable charges for residential and Watt Hour customers are inconsistent with the Order in Docket No. 10-0467 and thus are contrary to the provisions of the formula rate law.

A. Studies Submitted Pursuant to 2010 Rate Case Order

Cost of Service Directives

The Company filing responds to the directives from the Commission's 10-0467 Order by providing illustrative ECOSSs incorporating those directives in its filing. However, the Company does not incorporate the directives from the 10-0467 Order into its proposed ECOSS for this case, contending it is barred from doing so by the formula rate law. Staff is not arguing that those directives should be incorporated into the rate design for this case. (Staff Ex. 9.0, p. 5)

Staff, nevertheless, believes that the Commission should discuss those directives in its Order in this docket to give the parties direction on how to proceed on the issue. In that discussion, Staff recommends that the Commission state when ComEd should be expected to address those directives from the 10-0467 Order. Staff understands that Section 16-108.5 of the Act requires the Company to file a revenue neutral cost of service and rate design case within a year after the first set of formula rates go into effect. That proceeding, which focuses on cost of service and rate design, would provide a logical venue for addressing the Commission's directives from its 10-0467 Order. Therefore, in its Final Order, the Commission should direct ComEd to incorporate those directives in its cost of service study filed for the revenue neutral cost of service and rate design proceeding to follow this docket, pursuant to Section 16-108.5(e) of the Act. (220 ILCS 5/16-108.5(e)) This will present a clear signal to the Company and parties as to when and how the Commission expects these directives to be addressed. If, for some reason, the Commission prefers to wait until the next traditional delivery services rate case after 2021 to address these directives, it should state that as well to clearly communicate to the parties its intentions on this issue. (Staff Ex. 9.0, pp. 6-7)

The Company refuses to indicate when it believes these directives need to be addressed, stating in response to Staff's discovery:

> These studies and data may affect rate designs in subsequent proceedings not subject to this bar. ComEd cannot speculate as to exactly when such a proceeding will take place, but it must be a different proceeding from the current proceeding.
> (Staff Ex. 9.0, p. 7)

Based on this statement, it is not clear when the Company plans to address these directives and that may not be for another decade or longer depending on when ComEd files its next traditional rate case. That could present a problem if the Commission wishes to address its 10-0467 Order directives at an earlier juncture. (Staff Ex. 9.0, p. 7)

In rebuttal, ComEd witness Hemphill takes issue with Staff's recommendation that the Commission address the issue in its Order for this case. He argues that the recommendation "goes far beyond what the Commission ordered in Docket No. 10-0467 and far beyond what is appropriate." (ComEd Ex. 11.0, p. 22) He states that in requiring the Company to provide information and studies, the Commission "took great care not to order ComEd to *propose* those studies as *ComEd's position*." *(Id., emphasis* in original*)* Dr. Hemphill goes on to argue:

> The Commission can doubtless direct ComEd to provide and present data and analyses, and ComEd will comply, but ComEd is entitled to adopt the *position* result that ComEd believes is just and reasonable.
> (*Id*.)

Dr. Hemphill fails to accurately characterize all of the Commission directives on cost of service issues. Those directives not only required the Company to present information, they also mandated specific changes to the cost of service study ComEd presents in its next rate case filing. (Staff Ex. 20.0, p. 2) For example, the Commission stated in its 10-0467 Order about the use of direct observation:

> ComEd shall work with Staff on this issue to develop a scientifically-significant representative of its direct observations on this issue. It shall also have this representation in its cost of service study/studies in its next rate case. This analysis shall be part of any initial rate case filing that ComEd makes.
> (Final Order, Docket No. 10-0467, May 24, 2011, pp. 180-181)

This is a clear statement by the Commission requiring ComEd to revise its cost of service study to more appropriately incorporate the results of direct observations.

The Commission further required the Company to improve the sampling methods it used to distinguish primary and secondary costs and to factor "its analysis of these other utilities into its analysis of its primary and secondary costs." (Final Order, Docket No. 10-0467, May 24, 2011, p. 185). These directives clearly demand changes in the Company's cost of service approach and should not be considered optional, as Dr. Hemphill suggests. (Staff Ex. 20.0, p. 5)

Dr. Hemphill's rebuttal arguments conflict with his direct testimony on this issue, which note that the Company provided updated studies for illustrative purposes and then conclude:

> ComEd has not, however, changed its previously approved rate design in the rates proposed in this proceeding, and it has not included those materials in testimony. That is principally because this rate filing does not concern rate design, which is what those studies and data are about.
> (ComEd Ex. 1.0, p. 17)

There is nothing in that passage to support Dr. Hemphill's later contention that the Company "is entitled to adopt the *position* that ComEd believes is just and reasonable" regardless of the directives in the Commission's 10-0467 Order.

Thus, Dr. Hemphill's argument that "the Commission "took great care not to order ComEd to *propose* those studies as *ComEd's position*" clearly lacks merit. In fact, the Commission ordered that changes be made in the Company's cost of service approach and the issue that remains is when those changes are to be introduced. (Staff Ex. 20.0, p. 5)

In sum, the Commission's directives seek more than information or illustration. They require revisions to the cost of service studies sponsored by ComEd. The next meaningful opportunity to review and analyze those studies is in the upcoming revenue neutral cost of service and rate design cases required by Sec. 16-108.5(e) of the Act. Thus, the Commission should adopt Staff's recommendation and state in its Final Order for this case whether it wants the Company to provide the requisite studies and analyses in its initial filing for that proceeding. By doing so, the Commission will ensure that these issues are addressed in a timely manner. (Staff Ex. 20.0, pp. 5-6)

B. Rate Design, Including Upcoming Docket

Residential and Watt Hour Charges

The starting point for considering the Company's proposed rate design for Residential and Watt Hour customers is Sec. 16-108.5(c) of the Act which requires that "rate design and cost allocation across customer classes shall be consistent with the Commission's most recent order regarding the participating utility's request for a general increase in its delivery services rates." (220 ILCS 5/16-108.5(c))

The problem is that the Company's proposed fixed and delivery charges for the Residential and Watt Hour classes are not consistent with the most recent Order in 10-0467 and, therefore, they conflict with the provisions of the Act.
In the Order in Docket No. 10-0467, the Commission stated that volumetric charges for residential and Watt Hour customers should be set accordingly:

> In an effort to gradually move towards more realistic cost causation and to avoid rate shock, the Commission concludes that the use of volumetric charges be reduced so that they recover 50% of fixed delivery service costs.
> (Order, Docket No. 10-0467, May 24, 2011, p. 232)

Since rates for these customers consist of volumetric and fixed customer and meter charges, setting volumetric charges to recover 50% of fixed delivery costs means that fixed customer and meter charges should recover the remaining 50% of fixed delivery costs. (Staff Ex. 9.0, p. 9)

However, the Company calculated customer and meter charges in a different manner, proposing fixed charges that collectively recover 50% of <u>total</u> revenues for Residential and Watt Hour customers. This presents a problem because not all costs on the system are fixed costs. (Staff Ex. 9.0, p. 11) The Company has identified two cost components that it considers to be variable costs: the Illinois Electricity Distribution Tax ("IEDT") and the IEDT component of Uncollectible Accounts. Since the Company's proposed fixed charges recover 50% of all costs, including variable costs related to the IEDT, they are set too high. (*Id.*)

Based on this discussion, the Commission should approve the customer and meter charges for Residential and Watt Hour customers, meter and usage charges developed in Staff Ex. 9.0, Schedule 9.02. The approach in that schedule provides consistency with the Commission's 10-0467 Order by recovering 50% of <u>fixed</u> costs through fixed charges and the remaining 50% through variable charges. Furthermore, it ensures that IEDT costs are recovered through per-kWh charges as approved by the Order. This alternative approach improves upon the Company's proposed rates, which recover 50% of <u>total</u> costs through fixed charges and the remaining 50% through variable charges, an approach that clearly conflicts with the Commission Order in Docket No. 10-0467. (Staff Ex. 9.0, pp. 11-12)

ComEd witness Hemphill presents a number of flawed arguments against Staff's proposed Residential and Watt Hour charges. He begins by contending that "the time to argue that ComEd's filed rates do not comply with the Order has long since passed. (ComEd Ex. 11.0, p. 24) He goes on to argue that "[t]his docket is not an appropriate venue to attack that decision months later." (*Id*.)

This argument is misguided. The formula rate law requires that the rate design in this case be consistent with the 10-0467 Order. The Commission's language in that Order is clearly relevant to the determination of rate design in this case. Furthermore, when a mistake is discovered and the compliance rates are found to be flawed, it is difficult to conceive how basing rates in this case on an erroneous set of compliance rates guarantees consistency with the 10-0467 Order, which prescribes a different ratemaking approach. (Staff Ex. 20.0, pp. 6-7)

The underlying logic of Dr. Hemphill's objection appears to be that some kind of statute of limitations applies to uncovering ratemaking errors. The more reasonable position taken by Staff is that an error should be corrected regardless of when it is discovered. The current proceeding, which is supposed to base rate design on the 10-0467 Order, provides an appropriate venue for correcting this error. (Staff Ex. 20.0, p. 7)

Dr. Hemphill, nevertheless, seeks to justify the current ratemaking approach by pointing out how Staff and the Commission both signed off on the Company's compliance rates. (ComEd Ex. 11.0, pp. pp. 24-26) His argument is true, but irrelevant. Staff, and the Company for that matter, both failed to uncover the discrepancies between the 10-0467 Order and the compliance rate design for Residential and Watt Hour customers. The difference now is that Staff wants to correct the error while the Company seeks to perpetuate it. (Staff Ex. 20.0, p. 7)

Dr. Hemphill complains that Staff has taken a single sentence in the 10-0467 Order out of context. According to Dr. Hemphill, "Mr. Lazare bases his argument on the claim that the statement "… the use of volumetric charges be reduced so that they recover 50% of *fixed* delivery service costs …" means that fixed charges can also *only* recover 50% of fixed delivery costs." (ComEd Ex. 11.0, p. 27, emphasis in original) Dr. Hemphill contends, "[w]e know that because he plainly argues that 'The Commission should approve a set of customer and meter charges that collectively recover 50% of fixed costs <u>only</u>.'" (ComEd Ex. 11.0, pp. 27-28) The implication of Dr. Hemphill's argument is that the 10-0467 Order gives the Company the leeway to set fixed charges that recover more than 50% of fixed costs. (Staff Ex. 20.0, p. 8)

Dr. Hemphill fails to present a compelling argument. The 10-0467 Order contains no language to support ComEd's decision to set combined customer and meter charges equal to 50% of total costs. It is clearly inappropriate for fixed charges to recover a share of variable IEDT costs. The Commission plainly stated in its 10-0467 Order that "since the IEDT is related to usage, cost causation principles would argue for recovery through a per-kWh charge from all customers." (Order, Docket No. 10-0467, May 24, 2011, p. 285) Furthermore, Dr. Hemphill acknowledged that there is no place in the 10-0467 Order where the Commission states that Residential or Watt Hour customer charges should recover a share of variable costs. (*Tr*., March 7, 2012, p. 72) That means fixed charges can only recover fixed costs and since the Commission directed that variable charges recover 50% of fixed costs, fixed customer and meter charges should recover the remaining 50% of costs that are regarded as fixed costs for both the Residential and Watt Hour classes. (Staff Ex. 20.0, p. 9)

Dr. Hemphill seeks to solidify his position with two citations in the 10-0467 Order where the Commission recognizes "the importance of recovering fixed costs predominantly through fixed charges." (ComEd Ex. 11.0, p. 28) He argues that Staff's reading of the sentence "turns that principle on its head" because the Staff proposal would recover only 50% of fixed costs and, as a result, "fixed costs would not be recovered predominantly through the application of fixed charges." (ComEd Ex. 11.0, p. 29)

Dr. Hemphill's argument falls short because the 10-0467 Order does not state that fixed costs should be predominantly recovered through fixed charges in this case. The only language that pertains to the share of fixed costs is the Commission's statement that volumetric charges should "recover 50% of fixed delivery service costs." (Final Order, Docket No. 10-0467, May 24, 2011, p. 232) Based on this statement, fixed charges must be set to recover the remaining 50%, rather than a "predominant" amount of fixed costs.

Dr. Hemphill also contends that setting volumetric charges to recover 50% of fixed delivery service costs would create a problem because that would require increasing volumetric charges for both the Watt Hour and Residential Multi-Family Without Electric Space Heat delivery classes. (ComEd Ex. 11.0, pp. 29-30) His concern should be dismissed because whether volumetric charges would have to be increased or decreased is irrelevant to this discussion. What is relevant is that the Commission clearly stated that variable charges for Residential and Watt Hour customers should be calculated according to their share of fixed costs and rates should be designed accordingly. (Staff Ex. 20.0, pp. 11-12)

Dr. Hemphill further alleges that Staff gives the language of the 10-0467 Order "a meaning other than what it says." (ComEd Ex. 11.0, p. 30) According to Dr. Hemphill, the statement about recovering 50% of fixed costs refers to volumetric charges. He goes on to complain that Staff's proposed rate design focuses solely on the variable DFC [Distribution Facilities Charge] charge as the vehicle for recovering 50% of fixed costs and fails to carve out a role for the Illinois Electricity Distribution Tax Charge ("IEDT"). (*Id.*)

This argument is flawed as well. The IEDT charge should not be lumped together with the variable DFC in the rate design process because the Commission accorded it a separate role to recover distribution tax costs. The 10-0467 Order states as follows:

> In light of the Commission's prior treatment of the Illinois Electricity Distribution Tax in the Ameren Order, the Commission adopts ComEd's

> proposal to modify its rate design to provide a separate volumetric charge for the recovery of the Illinois Electricity Distribution Tax and uncollectible costs associated with the application of the tax for all of the reasons stated herein.
> (Final Order, Docket No. 10-0467, May 24, 2011, p. 285)

Since, the IEDT charge was established for the narrow purpose of recovering variable IEDT costs, it has no role to play in the recovery of 50% of fixed costs. Therefore, there is no basis for Dr. Hemphill's argument that this charge should be factored into the design of variable rates to recover 50% of fixed costs as stated in the Commission's 10-0467 Order. (Staff Ex. 20.0, pp. 11-12) Furthermore, as Dr. Hemphill acknowledges, the IEDT charge was not "developed by the Company for its compliance rates designed to recover any other costs besides the usage-based IEDT tax and IEDT related uncollectibles. (*Tr*., March 13, 2012, p. 75-76)

It should further be noted that there is nothing in Dr. Hemphill's discussion to support the Company's proposed rate design which sets fixed and variable charges to each recover 50% of total costs. Dr. Hemphill offers no justification whatsoever for ComEd's approach in the 10-0467 Order. Furthermore, he admitted he could find no place in the 10-0467 Order where the Commission states that either fixed charges or variable charges should be set to recover 50 percent of <u>total</u> costs. (*Tr*., March 13, 2012, p. 83) In fact, the Company's rate design is clearly inconsistent with that Order. Thus, if Dr. Hemphill's arguments against Staff's approach were found reasonable, that would create a quandary for the ratemaking process because there is no record evidence to show that ComEd's rate design in this docket is consistent with the 10-0467 Order. (Staff Ex. 20.0, p. 12)

Dr. Hemphill's position on this issue is inconsistent with arguments presented by ComEd in Docket No. 10-0467. After the Proposed Order ("PO") for that docket reached the same conclusion as the Final Order that volumetric charges should recover 50% of fixed delivery service costs, ComEd responded as follows in its Brief on Exceptions ("BOE"):

> As mentioned previously, ComEd proposed to recover 60%, 70%, and finally 80% of its delivery service costs attributable to residential and watt-hour customers through the application of fixed charges in the first year, second year, and thereafter, respectively. These percentages would apply to all costs, not just fixed costs. However, as adopted in the Proposed Order, the 50% SFV rate design appears to only apply to fixed costs, not to total delivery costs.
> (ComEd BOE, Docket 10-0467, p. 92)

In the above passage, the Company clearly understood that the percentages of costs on which charges are to be based applied to fixed costs, rather than total costs. Nevertheless, in its compliance rates for that case, the Company based charges for the two classes on total costs rather than fixed costs, in direct conflict with the Commission order on the case. (Staff Ex. 20.0, p. 13)

The evidence in this case clearly demonstrates that the Staff proposal for the Residential and Watt Hour classes is consistent with the 10-0467 Order while the ComEd proposal is not. Thus, the Commission should approve Staff's proposed rates for these classes.

C. Embedded Cost of Service Study, Including Distribution Losses

VIII. ADDITIONAL FORMULA / TARIFF ISSUES

A. Tariff Issues

1. Separate Statement of Earnings Collar Effect

2. Calculation of Increases for Three-Year Report

3. Other

B. Ratemaking Process and Filing Issues

1. Access to Information re Formula Rate Filing

2. Triggers for Hearing on Certain Operating Costs

3. Performance Condition for Incentive Compensation Costs

4. Other

C. Reconciliation

1. Average Rate Base Proposals (see also III.C.1)

As discussed in section III.C.1 above, the Commission should adopt the Intervenor and Staff proposals to use average rate base to calculate what the revenue requirement would have been if the actual cost information for the applicable calendar year had been available at the filing date in the annual reconciliation as provided for in subsections 16-108.5(c)(6) and 16-108.5(d)(1) of the Act. (Staff Ex. 16.0, pp. 33-34)

Subsection 16-108.5(c)(6) of the Act states that the performance based formula rate approved by the Commission shall:

> Provide for an annual reconciliation, with interest as described in subsection (d) of this Section, of the revenue requirement reflected in rates for each calendar year, beginning with the calendar year in which the utility files its performance-based formula rate tariff pursuant to subsection (c) of this Section, with what the revenue requirement would have been had the **actual cost information for the applicable calendar year** been available at the filing date.
> (220 ILCS 5/16-108.5(c)(6)) (emphasis added)

Further, Subsection 16-108.5(d)(1) describes the requirements and information to be included in future filings of updated cost inputs to the performance-based formula rate for the applicable rate year and the corresponding new charges, stating that:

> The filing shall also include a reconciliation of the revenue requirement that was in effect for the prior rate year (as set by the cost inputs for the prior rate year) **with the actual revenue requirement for the prior rate year (as reflected in the applicable FERC Form 1 that reports the actual costs for the prior rate year)**.
> (220 ILCS 5/16-108.5(d)(1)) (emphasis added)

Subsection 16-108.5(d)(1) concludes, stating that:

> **Notwithstanding anything that may be to the contrary**, the intent of the reconciliation is to ultimately reconcile the revenue requirement reflected in rates for each calendar year, beginning with the calendar year in which the utility files its performance-based formula rate tariff pursuant to subsection (c) of this Section, with what the revenue requirement would have been had the **actual cost information for the applicable calendar year** been available at the filing date.
> (220 ILCS 5/16-108.5(d)(1)) (emphasis added)

While the Act does not specifically state that either year-end or average rate base should be used in determining the reconciliation revenue requirement, the Act is specific and consistent in requiring actual cost information be used for the applicable calendar year, and not "as of" the applicable year end. (Staff Ex. 16.0, pp. 34-35)

Use of a year-end rate base calculates the reconciliation revenue requirement assuming that the plant in service at the end of the year was actually in service for the entire year, which is clearly not the case. In fact, when asked to confirm that the year end balance reported in the FERC Form 1 is indeed not representative of plant that was actually in service during the entire year, Company witness Ms. Houtsma responded "Yes, I would agree that not all of the plant in the year-end balance was in service from the beginning of the year forward." (*Tr.*, March 13, 2012, p. 944)

As additional evidence that use of year-end rate base is not reflective of actual cost for the applicable calendar year, one can examine depreciation expense, an operating cost directly related to plant in service. (Staff Ex. 16.0, p. 35) As discussed at hearing by a Company witness, the FERC Form 1 does not reflect a full year's worth of depreciation and amortization expense related to plant additions, because not all plant additions are in service for the entire year and plant additions don't begin to be depreciated until they go into service. If plant additions went into service midyear, for example, there would only be a half year of depreciation on those additions included in FERC Form 1 depreciation expense. This is true even though the entirety of plant additions, regardless of what date during the year they were placed into service, will ultimately be reflected in the year end balance of plant reported on FERC Form 1. (*Tr.*, pp. 941-944, March 13, 2012) Thus, FERC Form 1 depreciation expense, which is directly related to plant in service, is based on plant in service throughout the year, not on the balance of plant in service at the end of the year. Since depreciation expense is calculated periodically throughout the year on plant in service which increases throughout the year, an average rate base better corresponds to FERC Form 1 depreciation expense than does a year-end rate base. The Company's own schedules reflect this fact, by using average plant additions as a basis for calculating the "correspondingly updated depreciation and depreciation reserve" required by the Section 16-108.5(c)(6) of the Act. (ComEd Ex. 22.1, App 8, Ln. 48-51 & Ln. 13-17; 220 ILCS 5/16-108.5(c)(6))

The Company claimed that using average rate base in calculating the reconciliation revenue requirement ignores roughly half of the investment that happened during the year. (ComEd Ex. 20.0, p. 12) This statement is without merit. The use of year-end rate base in calculating the reconciliation revenue requirement illogically assumes that plant in service at the end of the year – on one specific date – is representative of the actual cost of plant for the calendar year – or throughout the entire year. (Staff Ex. 16.0, p. 35) As previously demonstrated by the Company's own testimony, year-end plant in service is simply not representative of the actual cost of plant in service for the year. (*Tr.*, March 13, 2012, pp. 941-944) The use of year-end rate base conveniently overlooks this obvious fact. The Company further incorrectly argued that the FERC Form 1 for any given year lists the total plant as of the end of that year because that amount "captures the activity for the year." (ComEd Ex. 20.0, p. 12) This argument is similarly inaccurate. It is impossible to determine what plant activity, if any, occurred during the year by observing in isolation year-end plant balance. Fortunately, FERC was perceptive enough to require submission of the plant beginning balance, additions, retirements, transfers, and adjustments for the year in its FERC Form 1. Cumulatively, this data does capture the activity for the year, and also provides the information required to determine average plant in service for the year. (Staff Ex. 16.0, pp. 35-36)

Using a year-end rate base overstates the actual revenue requirement during the reconciliation year. (IIEC Ex. 1.0-C, p. 24) Average rate base is more representative of the actual plant balances in service throughout the year, and more closely matches actual costs incurred during the year to the actual plant in service during the year. (Staff Ex. 16.0, p. 35) The Intervenors' testimonies illustrated that use of year-end rate base in calculating the reconciliation revenue requirement results in a significantly higher revenue requirement than if average rate base during the year is used.[15] The higher, more forward looking revenue requirement calculated using year-end rate base might be appropriate to use when setting rates prospectively,[16] but it is inappropriate for an after-the-fact historical evaluation of the actual revenue requirement during the year. Average plant in service is the superior measurement of plant in this instance, as it reflects a reasonable determination of the balance of increasing plant in service from the beginning of the year through the end of the year. As such, average rate base is more appropriate for use in calculating the reconciliation revenue requirement. (Staff Ex. 16.0, p. 35)

[15] See, for example, AG/AARP Ex. 1.0, p. 12.
[16] As stated in AG/AARP Ex. 4.0, pp. 11-12, year-end rate base is used in traditional ratemaking to determine rates to be in effect prospectively.

The Commission should accept the Intervenor and Staff proposals and require the reconciliation revenue requirement be calculated using average rate base. To implement these recommendations, the Commission should require a new work paper be incorporated into the Company's formula, which calculates the average rate base to be used in determination of the reconciliation revenue. Sch FR A-1-REC, Line 12 of the Company formula should be changed to both refer to the new work paper ("WP X: Average Rate Base – Reconciliation"), and to adopt the average rate base amount determined in the new work paper. (Staff Ex. 16.0, p. 37)

2. Interest Rate Proposals

Consistent with Commission practice, Staff's proposed reconciliation computation uses the interest rate on customer deposits approved by the Commission pursuant to 83 Ill. Adm. Code 280.70(e)(1) rather than the weighted average cost of capital proposed by ComEd. When calculating interest on reconciling amounts or balancing factors, the Commission generally uses the interest rate on customer deposits. For example, the interest rate on customer deposits is used for this purpose in ComEd's Rider PE, Rate BESH, Rider AMP, Rider RCA, and Rider UF. Using the weighted average cost of capital as ComEd proposes would treat the reconciliation amount like a rate base investment rather than a reconciling item. (Staff Ex. 1.0, pp. 17-18, lines 330-339)

Staff's position is that the interest rate for reconciliation amounts should be less than the rate of return on rate base assets. Staff avers that the Company's proposal to apply to reconciliation amounts an interest rate that equals the rate of return on rate base assets incorrectly assumes that reconciliation amounts are subject to the same risks as rate base assets. To the contrary, the rate of return on rate base compensates investors for prudence risk, which is not a risk factor for reconciliation amounts. (Staff Ex. 18.0, p. 25) As Company witness Houtsma notes, this proceeding will establish a formula rate that is updated annually to allow ComEd to recover its actual costs, no more and no less, on a timely basis. (ComEd Ex. 21.0, p. 25) As such, requiring customers to pay an interest rate that exceeds the investor-required rate of return would benefit ComEd shareholders at customers' expense. (Staff Ex. 18.0, p. 25)

Ms. Phipps explained that the Company reverses cause and effect when it argues that there is no evidence that ComEd would be able to finance any revenue shortfall at a lower rate than the weighted average cost of capital. (ComEd Ex. 12.0, p. 36) Here, the interest rate would apply to unrecovered costs, which are assets, not financial securities such as debt and equity. The Company's overall cost of capital (*i.e.,* the weighted average cost of capital on all of a company's assets) does <u>not</u> determine the required rate of return on new assets it acquires. The opposite is true. The weighted average of the required rates of return of the assets that a company holds determines its weighted average cost of capital. For example, as a company increases its holdings of low risk assets, such as U.S. Treasury securities, its overall cost of capital would decline. Should that company ultimately hold nothing but U.S. Treasury securities, its overall cost of capital would ultimately equal the weighted average required rate of return on those U.S. Treasury securities. In other words, determining a rate of return on financial securities is not necessary for determining the investor-

required rate of return on assets. That is, the manner in which ComEd would finance revenue shortfalls is a separate issue from determining the appropriate interest rate for reconciliation amounts. (Staff Ex. 18.0, p. 26)
Company witness Vogt testifies:

> The reconciliation amount will be recorded as an asset on ComEd's balance sheet. In essence it represents a loan to customers for services already provided.
> (ComEd Ex. 23.0, p. 16)

Ms. Phipps testifies that an AAA-rated bond yield would be a fair and reasonable benchmark for establishing the interest rate on reconciliation amounts given under-recovered amounts are essentially a loan from the Company to its customers; and credit rating agencies rated the Company's transitional funding instruments, which relied solely on the aggregate ability of ComEd's customers to pay, AAA. (Staff Ex. 18.0, pp. 26-27)

In the opposite situation, that is one in which ComEd's customers are due refunds, ComEd and its customers effectively switch roles: ComEd becomes the borrower, and its customers, the lenders. Under such circumstances, ComEd would be getting an outstanding deal, *i.e.*, the ability to borrow from customers at the customer deposit rate, which is well below ComEd's cost of short-term debt given its current ratings of BBB/Baa2 from Standard & Poor's/Moody's Investors Service. That is, if customers were compensated for the risk that ComEd could default on refunds, the interest rate would equal that for one-year, BBB/Baa2 rated debt. (Staff Ex. 18.0, p. 27; Staff Cross Ex. 2)

Company witness Houtsma contends that an interest rate below the Company's weighted-average cost of capital would not adequately compensate ComEd during the reconciliation periods because the true-up revenues for a given calendar year will not be complete until approximately three years after the start of that calendar year. (ComEd Ex. 12.0, pp. 35-36) In response, Staff notes that the appropriate interest rate is less a function of the days outstanding than the frequency of interest rate adjustment. For example, an interest rate on a thirty-year mortgage with an annual interest rate adjustment is different (and usually based on a one year benchmark interest rate such as the one-year U.S. Treasury yield) from that of a thirty-year fixed rate loan. Therefore, a one-year rate is appropriate for reconciliations since the Commission will adjust the interest rate on reconciliation amounts annually. (Staff Ex. 18.0, p. 27)

The current yield on one-year U.S. Treasury bonds, 0.14%, is very close to the 0.40% one-year yield on AA-rated corporate bonds. Furthermore, those yields are also very close to the current 0% Commission-authorized interest rate on customer deposits, determined in accordance with 83 Ill. Adm. Code 280.70(e). The customer deposit rate is the rate the Company applies to reconciliation amounts under ComEd's Rider Retail Customer Assessments for Purchase of Receivables Ordered Reconciliation Adjustment amounts in connection with Rider Purchase of Receivables with Consolidated Billing (PORCB). (Staff Ex. 18.0, p. 28)

Given the ease of administration in connection with Staff and the Company relying on a rate published annually by the Commission, and the small difference between the customer deposit rate and current yields on one-year AA financial securities, Staff recommends applying the Commission-authorized customer deposit rate to under-recovered amounts and refunds associated with the formula rate. (Staff Ex. 18.0, p. 28)

3. Regulatory Asset / Deferred Expense Recommendation

4. Other

D. Other Proposals and Positions Regarding Formula, Tariff Schedules and Attachments, and Processes

The Commission should approve the formula rate schedules and appendices to be included in the Company's Rider DSPP tariff as presented in Appendix B to this Initial Brief. Page 1 of Appendix B provides a roadmap of the specific changes recommended by Staff and the citations to testimony setting forth the reasons for those changes.

IX. OTHER

A. Distribution System Loss Study

Staff disagrees with ComEd's proposal to determine and allocate losses on its distribution system using a revised distribution loss study, identified as ComEd Ex. 7.1. (ComEd Ex. 7.0, pp. 5-6, Staff Ex. 11.0, pp. 2-8) Staff witness Rockrohr explains that he primarily objects to ComEd Ex. 7.1 because that distribution loss study updates class loads from 2009 to 2010, but does not include updated transmission losses. Since transmission losses can have as great an impact on distribution loss factors as incremental changes in class load, Mr. Rockrohr objects to ComEd's use of a distribution loss study for which transmission losses were most recently updated in the late 1990s. (Staff Ex. 11.0, p. 7) Rather than ComEd Ex. 7.1, Staff recommends that the Commission use the distribution loss study that ComEd identifies as Study Report #7B. ComEd asserts that Study Report #7B differs from ComEd Ex. 7.1, which ComEd proposes using, only in that Study Report #7B also uses the results of the updated transmission loss study that the Commission directed ComEd to complete by the end of 2011. As an alternative to using the distribution loss study ComEd identifies as Study Report #7B, Mr. Rockrohr recommends that the Commission continue using the distribution loss study that it approved in Docket No. 10-0467. (Staff Ex. 22.0, p. 6) The U.S. Department of Energy agrees with Staff's primary and alternative recommendations regarding ComEd's distribution loss studies. (DOE Ex. 1.0, pp. 8-9)

B. Study Report #5

ComEd submitted a confidential and proprietary report, "Study Report #5," which describes ComEd's use of various Railroad Class customer-owned facilities to supply its other customers. The report describes steps ComEd could take to eliminate its dependence on and use of CTA and Metra facilities to supply other customers. Staff witness Rockrohr explains his understanding that ComEd's Study Report #5 indicates that it would cost less for ComEd to eliminate its dependence upon the Railroad Class customer-owned facilities than to completely eliminate ComEd's use of those facilities. (Staff Ex. 11.0, pp. 9-12) No party has asked for or recommended that the Commission take any action in this Docket regarding Study Report #5, which ComEd states it submitted for informational purposes. (ComEd Ex. 17.0, p. 13, Staff Ex. 11.0, p. 12, CTA/Metra Joint Ex. 3.0)

Even though no party has asked the Commission to take any action based upon Study Report #5, CTA /Metra witness James Bachman states in rebuttal testimony that Staff witness Rockrohr implies that there is a requirement that ComEd and the Railroads must take immediate steps to eliminate the use of the railroad traction substations to serve other ComEd customers. (CTA/Metra Joint Ex. 3.0, pp. 5) Mr. Rockrohr intended no such implication. Mr. Bachman also disagrees with Mr. Rockrohr's understanding of the direct cost estimates that ComEd provided in Study Report #5, and takes issue with Mr. Rockrohr's use of the word "subsidy" to describe ComEd's shifting of Railroad Class customer service costs to other customer classes as a result of the Commission's Final Order in Docket 10-0467. (CTA/Metra Joint Ex. 3.0, pp. 5-6) These additional disagreements brought up by Mr. Bachman do not appear to Staff to be relevant to this proceeding, nor has Mr. Rockrohr's understanding or opinion changed as a result.

X. CONCLUSION

WHEREFORE, for all of the following reasons, Staff respectfully requests that the Commission's order in this proceeding reflect all of Staff's recommendations regarding the Company's tariffs and charges submitted pursuant to Section 16-108.5 of the Public Utilities Act.

Respectfully submitted,

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